Supreme Court, U.S.
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In The
Supreme Court of The United States
October Term 1996

VEMCO, INC., a Michigan corporation,
Petitioner,

v.

FEDERAL INSURANCE COMPANY,
a New Jersey corporation,
Respondent.

Petition For A Writ Of Certiorari
To The United States Court of
Appeals For The Sixth Circuit

PETITION FOR WRIT OF CERTIORARI
with Appendices

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QUESTION PRESENTED FOR REVIEW

Whether a construction surety's written agreement to submit an existing controversy to arbitration is valid, irrevocable, and enforceable under the Federal Arbitration Act, notwithstanding the surety's prior unsuccessful objection to court-ordered arbitration.

PARTIES TO THE PROCEEDING

The Petitioner, Vemco, Inc., is a subsidiary of Venture Holdings Trust, a Michigan Trust.

The Respondent, Federal Insurance Company, is a wholly-owned subsidiary of Chubb Son, Inc., a publically-traded company.

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PETITION FOR WRIT OF CERTIORARI

Vemco, Inc. ("Vemco"), respectfully asks that a writ of certiorari issue to review the Judgment of the United States Court of Appeals for the Sixth Circuit in this case as to Federal Insurance Company ("Federal"), only.

OPINIONS BELOW

The opinions of the Court of Appeals for the Sixth Circuit vacating the arbitration award and denying the Petitioner's motion for rehearing are unreported. They are reproduced in Appendices ("Apdx.") A and B, respectively.

The opinions of the District Court for the Eastern District of Michigan ordering arbitration, refusing to stay arbitration, confirming the arbitration award, and entering final judgment are also unreported. They are reproduced at Apdx. C, D, E, and F, respectively.

STATEMENT OF JURISDICTION

Jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1).

The decree for which Petitioner seeks review was entered by the Court of Appeals on September 5, 1996. Petitioner filed a timely petition for rehearing on

September 18, 1996, which was denied on October 18, 1996.

STATUTORY PROVISIONS INVOLVED

The statutes involved are sections 2 and 10 of the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*

9 U.S.C. § 2

§ 2. Validity, irrovacability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction or the refusal to perform the whole or any part thereof, or **an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.** (emphasis added)

9 U.S.C. § 10

(a) In any of the

following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration - -

* * * * *

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

STATEMENT OF THE CASE

A. Overview and Summary

This petition involves a construction surety's written agreement to submit an existing construction controversy to arbitration after a District Court had ordered arbitration and the surety had unsuccessfully opposed the District Court's order. Under the Federal Arbitration Act and precedent from this Court, the surety's written arbitration agreement was valid, enforceable, and irrevocable. However, the Sixth Circuit Court of Appeals disagreed and refused to enforce the surety's arbitration agreement, finding that the surety had merely abided by the District Court's arbitration order.

The record before the Court of Appeals was uncontroverted. It discloses that after the District Court ordered arbitration, counsel for the surety and the owner had entered into extensive negotiations regarding whether the surety would be deemed bound by the court-ordered arbitration -- the issue those days being whether a construction surety company could be compelled to join in an arbitration between owner and contractor. The negotiations culminated in a written agreement from the surety which provided:

> "Please be advised that Federal Insurance Company [the Respondent] has agreed to participate in and be bound by the above arbitration proceedings both as to surety and non-surety issues."

The arbitration, involving Vemco as owner, Flakt, Inc. ("Flakt") as contractor, and Federal as surety, lasted over 114 days and resulted in an award of $3,111,422.44, plus interest, in favor of Vemco against Federal and Flakt.[1] The District Court confirmed the arbitration award and entered judgment, finding that the surety had issued a performance bond to Vemco on behalf of the contractor, had agreed to be bound by the arbitration, and had presented no reason why it should not be so bound.

In its vacation of the arbitration award, the Court of Appeals apparently assumed that the District Court Order to arbitrate had rendered superfluous the construction surety's *subsequent* agreement to arbitrate. This assumption is

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[1]Flakt, the contractor, joined in the surety's challenge to the court-ordered arbitration. However, unlike the surety, Flakt did not subsequently agree to be bound by the arbitration and, thus, Vemco has not contested the vacation of the arbitration award as to Flakt.

not only erroneous, but injects uncertainty as to the viability of a major portion of the Act -- that which allows parties to agree to settle *existing* controversies through arbitration.

Having initially objected to the arbitrability of the dispute, Federal's participation in the arbitration proceedings pursuant to a court order would not have forced Federal to accept the arbitration results as final and binding under the Federal Arbitration Act statutory scheme because, under the Act, a party who has objected to arbitration can challenge the finality and binding effect of the arbitration on the grounds that the dispute was not arbitrable. See 9 U.S.C. § 10(a)(4). Federal's subsequent agreement to arbitrate was a negotiated waiver of this statutory right and, therefore, was not superfluous. Such a negotiated Agreement was absolutely enforceable as a post-dispute arbitration agreement under 9 U.S.C. § 2.

In light of the fact that agreements transferring existing disputes from court to arbitration are common occurrences and of the federal policy favoring the enforcement of arbitration agreements enunciated in Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1 (1983) and its progeny, the error by the

Court of Appeals presents an important question of federal law that has not been, but should be, settled by this Court. The instant Petition should, therefore, be granted.

B. <u>The District Court Proceedings</u>

The current controversy arose out of a construction contract dispute between Vemco and Federal's principal, Flakt. By written agreement in 1987, Vemco, an autoparts manufacturer, contracted with Flakt to have the latter design, engineer, and build a paint finishing system for Vemco's new automobile parts plant in Grand Blanc, Michigan. Respondent Federal, a New Jersey corporation, issued a $13.5 million performance bond, which was later increased to $15 million, to guarantee Flakt's work. Although the construction contract contained arbitration clauses, the performance bond did not.

The project was plagued with numerous construction problems. On August 1, 1988, Vemco demanded arbitration citing several arbitration clauses contained in the agreements between Vemco and Flakt. After Flakt failed to cooperate with Vemco's arbitration demand, Vemco filed a lawsuit against Flakt, but not Federal, in the United States District Court for the Eastern District of Michigan, seeking, *inter alia*, to compel arbitra-

tion of the parties' contractual dispute. The District Court had jurisdiction over the cause pursuant to 28 U.S.C. § 1332, based on diversity of citizenship and in excess of $50,000 in controversy.

Upon Vemco's motion, on September 9, 1988, Judge Stewart A. Newblatt, the presiding District Court Judge, entered a temporary restraining order which, in part, ordered Flakt, but not Federal, to proceed with arbitration. Apdx. C-17.

Federal appeared in the litigation picture as of September 27, 1988, when it joined in Flakt's Counterclaim and subsequent Motion against Vemco, seeking, *inter alia*, a stay of the arbitration, alleging that the arbitration clauses at issue did not compel the arbitration of many of the matters in controversy between Vemco and Flakt. On March 23, 1989, the District Court denied the objections to the arbitrability of these matters and refused to stay arbitration, leaving intact its September 9, 1988 order mandating Flakt to arbitrate.[2]

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[2]Federal argued on appeal that the District Court's March 23, 1989 Order rejecting Federal's objections to arbitration also mandated Federal to arbitrate the dispute. Vemco will accept Federal's interpretation of the District Court's March 23, 1989 Order for the limited purpose of this Petition, inasmuch as the issue does not materially affect the resolution of the question

Apdx. D-21.

Following the entry of the District Court's March 23, 1989 Order refusing to stay arbitration notwithstanding Federal's objections, counsel for Federal and Vemco engaged in an exchange of letters over a period of two months as to whether Vemco had a legal basis to compel Federal to join in the arbitration and, if so, what issues Federal was bound to arbitrate. See Apdx. G-47. The legal issue those days was whether a construction surety whose construction bond did not contain an arbitration provision could be compelled to join in an arbitration proceeding between an owner and a contractor. On March 31, 1989, after lengthy negotiations, Federal agreed to submit to and be bound by arbitration as to all issues arising out of the ongoing controversy.[3]

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presented to this Court.

[3]The following is a chronological account of the negotiations between Vemco and Federal, which culminated in Federal's Agreement to arbitrate and to be bound by arbitration:

On March 30, 1989, seven days after the District Court's refusal to stay the arbitration between Vemco and Flakt, counsel for Vemco wrote to Federal's counsel, confirming that discussions were ongoing as to whether Federal would agree to arbitrate. See App. G-47 ("Mr. Monahan will advise Mr. Wittlinger on or before March 31, 1989, whether the bonding company will agree to be bound by the decision of the arbitrators"). On March 31, 1989, these discussions culminated

in Federal's Agreement to arbitrate and to be bound by the arbitrators' decision as to Flakt's principal liability, but not as to surety issues (i.e., special defenses of the surety not available to its principal, such as invalidity of the bond, special statute of limitations, or actions releasing the surety). See App. G-50 ("Federal Insurance Company agrees that it will be bound by the arbitration proceedings as to those issues which are arbitrated. There may be separate issues relating solely to the surety bond which are not part of the arbitration"). On April 14, 1989, Federal's counsel wrote to the American Arbitration Association, confirming its decision to agree to arbitration. See App. G-55 ("Furthermore, it has been Flakt's position that Federal Insurance is not even a proper party to the arbitration proceeding because Federal Insurance had not agreed to arbitrate any dispute with Vemco. Federal Insurance subsequently agreed to be bound by the arbitration concerning non-surety issues"). On May 1, 1989, counsel for Vemco wrote to Federal's counsel confirming the parties' understanding that Federal would agree to submit itself to arbitration, thereby waiving its previous objections. App. G-57 ("The bonding company, Federal Insurance Co., will agree to be bound by the decision of the arbitrators"). On May 3, 1989, Vemco's counsel wrote to the American Arbitration Association to report Vemco's and Federal's Agreement that the latter would voluntarily submit itself to arbitration. App. G-59 ("Since Federal Insurance Company has agreed to be bound by the arbitration proceeding concerning non-surety matters, Federal Insurance Company should remain in the arbitration").

After Federal agreed to voluntarily submit itself to arbitration and be bound by the arbitrators' determination as to Flakt's principal liability, Vemco and Federal continued negotiations as to whether Federal should also agree to submit to arbitration the surety issues-- Vemco's intention being to otherwise seek to compel Federal to do so and/or add Federal as a Defendant in the District Court proceedings. See App. G-61 ("We request that Federal Insurance Company agree to be bound in the arbitration on all issues, not merely non-surety issues. The request is made for the following reasons: . . .

On June 19, 1989, Vemco reported to the District Court Federal's decision to agree to arbitration and to be bound thereby as to all issues, including the arbitrators' determination of Flakt's underlying liability. Apdx. H-64 ("Counter-Plaintiff Federal Insurance Company has agreed to participate in and be bound by the arbitration issues as to both surety and non-surety issues in this case"). The matter proceeded to arbitration with Federal's participation.

The arbitration hearings encompassed 114 hearing days from September 1989 through 1992. The arbitration concluded in a September 1, 1993 arbitration award of approximately $3.1 million to Vemco and against Flakt and Federal, jointly and severally. On November 10, 1993, Flakt challenged the finality and binding effect of the arbitration award essentially on the same grounds upon which it had sought a stay of the arbitration five years earlier (to wit,

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If the Federal Insurance Company does not agree to be bound on all issues in the arbitration proceeding, Vemco will file a motion to add the appropriate counts against Federal Insurance Company in the Federal Court proceeding"). Ultimately, on May 30, 1989, Federal agreed with Vemco to also arbitrate the surety issues. See App. G-63 ("Please be advised that Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety issues and non-surety issues").

the District Court had no authority to send to arbitration all of the issues). See Apdx. E-34. Although Federal had not filed a motion challenging the arbitration award, the District Court, nevertheless, addressed the validity and finality of the arbitration award as to both Flakt and Federal.

With respect to Federal, the District Court made a factual determination that Federal had agreed to arbitrate and to be bound by the arbitration and, furthermore, had not provided any reasons as to why its Agreement to be bound by arbitration should not be enforced. Apdx. E-34. Accordingly, on April 6, 1994, the District Court entered its judgment in favor of Vemco. Apdx. F-39.

C. Proceedings in the Court of Appeals

Flakt and Federal filed notices of appeal from both the District Court Order confirming the arbitration award and its subsequent judgment on the same. On June 15, 1994, the appeals were consolidated at Vemco's request under Case No. 94-1016/1506. Flakt and Federal argued on appeal that the District Court orders should be vacated because the District Court had referred to arbitration matters which were not arbitrable and, therefore, the arbitration award was not final and

binding as to them. Vemco, of course, disagreed with that position.

On appeal, Vemco asserted that Federal was liable on the arbitration award, even if the award were vacated as to Flakt, because Federal had negotiated its Agreement to be bound by arbitration and, therefore, had waived its objections to arbitration, as well as its right to appeal.

On September 5, 1996, the Court of Appeals entered an Order in which it concluded that the District Court had erred by sending all of the disputes to arbitration without first determining specifically which issues were arbitrable. Apdx. A-1. Accordingly, the Court of Appeals vacated the arbitration award and remanded it to the District Court for a determination of arbitrable issues. Apdx. A-1

With respect to Federal, the Court of Appeals rejected Vemco's contention that Federal was bound by the arbitration award. Specifically, the Court of Appeals concluded that Federal "did not waive their right to appeal by arguing their claims before the arbitration panel" because Federal had merely "abided by the district court's determination that all but two issues were arbitrable." Apdx. A-1.

On September 18, 1996, Vemco filed a petition for rehearing in the Court of Appeals on the sole issue of Federal's liability on the arbitration award pursuant to Federal's Agreement to be bound by the same. That petition was denied, see Apdx. B-15, and the instant petition for a writ of certiorari ensued.

REASONS FOR GRANTING THE WRIT

When the Court of Appeals decided that Federal had merely "abided by the district court's determination" to arbitrate and, thus, had not waived its right to contest the finality of the arbitration award, the Court of Appeals necessarily decided that Federal's separate and uncontroverted negotiated Agreement to be bound by arbitration was not enforceable under the Federal Arbitration Act. This decision is erroneous as a matter of law and contradicts clear precedent from this Court. Moreover, this decision will have significant repercussions in the enforcement of a major portion of the Federal Arbitration Act -- that which allows parties to agree to arbitrate already ongoing disputes -- because it inhibits the voluntary binding settlement of controversies through arbitration at any time during the trial court proceedings.

A. Federal's Agreement to Arbitrate and to Be Bound by Arbitration is Uncontroverted by the Record

A surety company has the right to separately settle or agree to a method of settlement with respect to an owner's claims against the surety company while the contractor and owner continue the dispute. See generally Fidelity and Deposit Co. of Maryland v. Bristol Steel and Iron Works, 722 F.2d 1160 (4th Cir. 1983); see also ARMEN SHAHINIAN, STRATEGIC USE OF THE GENERAL INDEMNITY AGREEMENT IN SETTLING BOND CLAIMS OVER A PRINCIPAL'S OBJECTION, ABA Tips Fidelity and Surety Law Committee, January 26, 1996 (attached as Apdx. I-78, see pp. I-92-93) ("Most [General Indemnity Agreements], either as part of the general indemnity clause or set forth in a separate section, give the surety an express right to settle claims asserted against it *** Such provisions are designed to allow the surety to compromise and resolve claims efficiently and to avoid unnecessary litigation"). Thus, notwithstanding the general principle that a surety's liability is only derivative of the principal's, a surety can exercise its independent right to settle a claim by designating the method by which its exposure under a claim is to be determined, in order to avoid unnecessary litigation.

In this case, Federal exercised its independent right to agree to have its exposure decided once and for all in arbitration. Indeed, the fact that Federal agreed to arbitrate and to be bound by the arbitration was not only uncontroverted by the record, see supra n.3, but was also admitted by Federal during the proceedings in the District Court.[4] Further, throughout the appellate proceedings, Federal never denied entering into an Agreement to arbitrate

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[4]On June 19, 1989, Vemco reported to the District Court Federal's decision to waive its objections to arbitration by voluntarily submitting to arbitration surety issues and agreeing to be bound by the arbitrators' decision on Flakt's principal liability. See App. H-64 ("Counter-Plaintiff Federal Insurance Company has agreed to participate in and be bound by the arbitration issues as to both surety and non-surety issues in this case"). Federal never objected to Vemco's statement to the Court but, rather, proceeded to arbitrate. Moreover, after the conclusion of the arbitration proceedings, Federal admitted entering into an Agreement to arbitrate and to be bound by arbitration. See App. J-139 [Vemco's Motion for Confirmation of Arbitration Award and For Final Judgment on Arbitration Award] ("Federal specifically agreed to be bound by the arbitration proceedings as to those matters which were to be arbitrated"); App. K-149 [Flakt and Federal's Response Opposing Vemco's Motion for Confirmation of Arbitration Award and For Final Judgment on Arbitration Award] ("Flakt and Federal admit the averment"); App. E-34 [District Court Order Confirming Arbitration Award] ("Federal agreed to be bound by the arbitration. Federal has presented no reason why it should not be bound") (citations omitted).

and to be bound by arbitration.[5]

In sum, Federal's Agreement to arbitrate and to be bound by arbitration is absolutely uncontroverted in this case.

B. Federal's Agreement to Arbitrate And to Be Bound by Arbitration Falls Squarely Within the Ambit of the Federal Arbitration Act

The Federal Arbitration Act provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction or the

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[5]Federal's appellate argument against the enforcement of its Agreement to arbitrate and to be bound by the arbitration was limited to the assertions that it had "no hint that Federal could be liable even if an award against Flakt were reversed on appeal;" and that its right to appeal or waive its previous objections to the arbitrability of the dispute had not been subject to a "clear and unequivocal waiver." Federal's argument alleging ignorance of the legal repercussions of its Agreement to be bound by arbitration was unsupported by any case law. Moreover, Federal's argument that its Agreement to be bound by arbitration was not a clear and unequivocal waiver of its objections to arbitration was also baseless, as this Petition demonstrates.

> refusal to perform the whole or any part thereof, or **an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable**, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (emphasis added).

The Agreement at issue in this case stated as follows:

> Please be advised that Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety and non-surety issues.

See Apdx. G-47-63. This written Agreement was an unreserved submission of the ongoing controversy between Vemco and Federal to binding arbitration and, therefore, falls squarely within the ambit of the Federal Arbitration Act.

C. The Existence of a Court Order Purportedly Mandating Federal to Participate in Arbitration Did Not Render Superfluous Federal's Subsequent Agreement to Arbitrate and to Be Bound by Arbitration

As a matter of law, Federal was not merely implementing a District Court Order when it agreed to arbitrate and to be bound by arbitration, as the Court of Appeals concluded. Instead, Federal was negotiating away specific rights under the Federal Arbitration Act, which the District Court did not, and could not, have taken away when it purportedly ordered Federal to participate in Arbitration.

The Federal Arbitration Act provides in part:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration - -

* * * * *

> (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10.

Federal's objections to the District Court Order mandating Flakt to arbitrate the dispute went directly to the issue of the arbitrators' lack of authority to hear the underlying dispute. Having expressed such objections, Federal had, to that point, reserved its statutory prerogative to appeal the finality and binding effect of the arbitration. Its participation in the arbitration proceedings pursuant to a court order would not have changed that.

Federal's *subsequent* Agreement to arbitrate and to be bound by arbitration negotiated away Federal's statutory right under the Federal Arbitration Act to

challenge the finality and binding effect of the arbitration and, therefore, was not superfluous. Indeed, Vemco gave Federal valuable consideration for Federal's Agreement; Vemco refrained from amending its pleadings in the District Court to seek relief upon the surety bond, from seeking to compel Federal to participate in the arbitration proceedings, and from seeking a detailed arbitration award against Federal. Moreover, through its arbitration Agreement, Federal gained the certainty that the claims asserted against it would be settled efficiently and without unnecessary litigation.

In sum, when Federal entered into an Agreement to arbitrate and to be bound by arbitration, Federal was doing much more than that which was ordered by the District Court. Because Federal's Agreement was negotiated, not dictated by the District Court, it was not superfluous and should have been enforced.

D. Even if Federal's Agreement to Arbitrate and to Be Bound by Arbitration Were Ambiguous, the Court of Appeals Should Have Resolved All Doubts In Favor of Arbitration.

It is hard to imagine an agreement

to arbitrate an ongoing dispute which is broader than the one to which Federal agreed: "Please be advised that Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety issues and non-surety issues." Indeed, even the most cursory review of the verbiage reveals that Federal conclusively agreed to arbitrate all issues between the parties and to be bound by the arbitration results without any reservation whatsoever.

However, even if the Agreement were ambiguous, the Court of Appeals still had an obligation to find in favor of arbitration. Section 2 of the Federal Arbitration Act is "a congressional declaration of a liberal federal policy favoring arbitration agreements . . ." Moses, 460 U.S. at 24. As this Court has clearly held, "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." Id. Further, this Court has announced time and time again that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of

waiver, delay, or a like defense to arbitrability." Id. at 24-25. See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985) ("as with any other contract, the parties' intentions control, but those intentions are generously construed as to issues of arbitrability"); Volt Inf. Sciences v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 475-76 (1989) ("in applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Act, due regard must be given to federal policy favoring arbitration and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration") (citation omitted); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. ____, 115 S. Ct. 1212, 1218 (1995) (same).

The presumption for arbitrability in the interpretation of an arbitration contract or clause is particularly applicable in cases where, like here, the language suggesting arbitration as remedy is broad. See AT&T Technologies v. Communications Workers of America, 475 U.S. 643, 650 (1986). In cases like this one, where the arbitration language is broad, "only the most forceful evidence

of a purpose to exclude the claim from arbitration can prevail." Id.; see also United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 584-85 (1960) (same).

Here, there was no evidence whatsoever which supported the conclusion that Federal's Agreement to arbitrate the dispute and to be bound by the arbitration meant anything other than what the Agreement's plain language suggested; that Federal agreed to arbitrate and to be bound by arbitration without any reservation of its previous objections to arbitration.

Moreover, the conclusion that Federal had agreed to arbitrate all issues with no remaining objections was the only one supported by state law, in light of the fact that Federal, and not Vemco, was the party who drafted the Agreement to arbitrate and to be bound by the arbitration results.

> Where one party chooses the terms of a contract, he is likely to provide more carefully for the protection of his own interests than for those of the other party. He is also more likely than the other party to have reason to

> know of uncertainties of meaning. Indeed, he may leave meaning deliberately obscure, intending to decide at a later date what meaning to assert. In cases of doubt, therefore, so long as other factors are not decisive, there is substantial reason for preferring the meaning of the other party.

Mastrobuono, 115 S. Ct. at 1219 n.10 (quoting RESTATEMENT (SECOND) OF CONTRACTS § 206, Comment a (1979)).

E. Federal's Agreement to Arbitrate and to Be Bound by Arbitration Was Tantamount to a Waiver of Its Objections and, Therefore, of Its Right to Appeal the Arbitration Award

As this Petition has discussed, supra pp. 21-23, Federal did not need to agree to the arbitration in order to comply with the District Court Order purportedly mandating Federal to participate in arbitration. Therefore, Federal's Agreement to arbitrate and to be bound by the arbitration award went far beyond that which the District Court

required from Federal.[6]

A party who enters in an agreement to arbitrate cannot later be heard to say in the trial court or on appeal that the arbitration was invalid. E.g., Benjamin F. Shaw Co. v. Cincinnati Gas & Elect., 633 F. Supp. 841, 845 (S.D. Ohio 1986) (quoting Jones Dairy Farm v. Local No. P-1236, United Food and Commercial Workers Int'l Union, AFL-CIO, 760 F.2d 173, 175 (7th Cir. 1985)) ("if a party voluntarily and unreservedly submits an issue to arbitration, he cannot later argue that the arbitration had no authority to resolve it"); see also Ficek v. Southern Pac. Co., 338 F.2d 655, 657 (9th Cir. 1964), cert. denied, 380 U.S. 988 (1965) (a party may not voluntarily submit a claim to arbitration and, then, if the arbitrators' decision is unfavorable, challenge the authority of the arbitrators to act). Therefore, by agreeing to arbitrate and to be bound by arbitration, Federal forever barred itself from objecting to the arbitration award or from appealing the District Court Order affirming the same.

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[6] Absent an intent by Federal to be bound, there is no explanation for the two months of negotiations between the parties.

F. The Court of Appeals Had an Absolute Duty Under the Federal Arbitration Act and Supreme Court Precedent to Enforce Federal's Agreement to Arbitrate and to Be Bound by the Arbitration Award

The only way in which Federal could have validly avoided the enforcement of its Agreement to arbitrate and to be bound by arbitration was by demonstrating that some valid ground existed at law or in equity for the Agreement's revocation. Federal presented no grounds for revocation of the Agreement in the District Court or the Court of Appeals. Therefore, Federal's Agreement to arbitrate and to be bound by arbitration was "valid, irrevocable, and enforceable" under the Federal Arbitration Act. 9 U.S.C. § 2 (a written agreement to arbitrate a dispute involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract").

By its terms, the Federal Arbitration Act leaves no place for the exercise of court discretion, as this Court clearly announced in Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 218 (1985). Thus, the Court of Appeals had

an absolute duty to enforce Federal's Agreement.

G. A correction of the Court of Appeals' Error Is of the Highest Importance in Carrying Out the Legislative Purpose in the Federal Arbitration Act

"The legislative history of the [Federal Arbitration] Act establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate." Dean Witter, 470 U.S. at 219. As this Court has recognized numerous times, the purpose of the Federal Arbitration Act is to place arbitration agreements "upon the same footing as other contracts, where [they] belong, and to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate." Id. (quoting HR Rep No. 96, 68th Cong. 1st Sess, 1 (1924)). The Court of Appeals' failure to enforce Federal's unambiguous Agreement to arbitrate and to be bound by arbitration, therefore, cut against the very grain of the Federal Arbitration Act.

Moreover, the Court of Appeals' refusal to enforce Federal's unambiguous Agreement to arbitrate and to be bound by

arbitration, simply because the parties to that Agreement had not settled their dispute on arbitrability prior to the involvement of the District Court, injects uncertainty into the viability of a major portion of the Arbitration Act -- that which allows parties to agree to settle *existing* controversies through arbitration. 9 U.S.C. § 2.

As this Court well knows, the legal reporters are replete of cases which, like this one, involve arbitration agreements and parties who, notwithstanding those agreements, dispute the arbitrability of the controversy. By definition, those cases exist because the issue of the arbitrability of the dispute has not been settled by the parties.

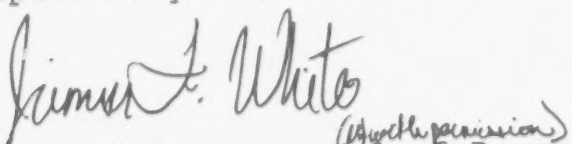
Once the parties are involved in an ongoing court battle over the underlying controversy, they have little incentive to settle their differences with respect to the arbitrability of the dispute prior to a determination of the same by the trial court. After all, the cost of determining the issue of arbitrability is negligible when compared to the cost of the entire litigation, which is already ongoing. As a result, many of the agreements to arbitrate *existing* controversies under the Federal

Arbitration Act are not realized until events in the litigation force the parties to seek alternative means to resolve their disputes. Contrary to the Court of Appeals' conclusion in this action, those agreements are, and must continue to be, enforceable under the Federal Arbitration Act. Therefore, it is imperative to the continued vitality of the Federal Arbitration Act that this Court review and correct the Court of Appeals' significant error.

CONCLUSION

For the reasons set forth above, the Court's standards set forth in Sup. Ct. Rule 10.1 for granting certiorari are satisfied and the instant Petition should be granted.

Respectfully submitted,



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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

OPINION

NOT RECOMMENDED FOR PUBLICATION
Nos. 94-1016/1506

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

VEMCO, INC., a Michigan corporation,	)	
Plaintiff/Counter-defendant-Appellee,	)	
v.	)	ON APPEAL FROM THE U.S. DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN
FLAKT, INC., a Delaware corporation, and FEDERAL INSURANCE COMPANY, a New Jersey corporation,	)	
Defendants\Counter-plaintiffs-Appellants.	)	**OPINION**
JAMES A. SCHUTZ, et al. THOMAS J. KELLY, in his capacity as individual collateral agent on behalf of The New York Life Insurance Company and Aid Association for Lutherans; NEW YORK LIFE INSURANCE COMPANY, a New York corporation; AID ASSOCIATION FOR LUTHERANS, a fraternal benefit society organized under the laws of the State of Wisconsin.	)	
Counter-defendants.	)	

BEFORE: **KRUPANSKY**, **RYAN**, and **NORRIS**, Circuit Judges.

ALAN E. NORRIS, Circuit Judge. In this diversity action, defendants Flakt, Inc. ("defendant") and Federal Insurance Company ("Federal") appeals the district court order denying this motion to vacate an arbitration award in favor of Vemco, Inc. ("plaintiff"), pursuant to § 10(a)(4) of the Federal Arbitration Act ("FAA"), 9 U.S.C.A. §§ 1-16 (West 1970 & Supp. 1996). For the following reasons. we reverse the decision of the district court and vacate the arbitration award.

I. FACTS

Plaintiff is an autoparts manufacturer that contracted with defendant to design and build a paint finishing system for plaintiff's new-automobile parts plant. Several written agreements memorialized the parties deal, and each was executed on the same day in November of 1987 and back-dated to July of 1987. Two of the agreements are central to this appeal. In the Cost-Plus agreement, defendant assumed "total responsibility for all phases of the design, fabrocation, installation, start up, testing, and completion of the paint finishing

system." This sixty-one page agreement contained a limited warranty provision, a provision protecting defendant from claims for consequential damages, and four arbitration clauses. The two-page Guaranteed Maximum Cost agreement supplemented the Cost-Plus agreement and established a maximum cost of $15 million for the "originally-quoted system." The parties also agreed that Federal would issue a performance bond to guarantee defendant's work.

By June of 1988, the project was in serious trouble. Defendant asserted the total project cost had risen to $19 million due to plaintiff's numerous "Owner Change Requests." Plaintiff asserted that virtually all the change requests were not changes at all, but rather were required to meet the contract specifications of the "originally-quoted system." Plaintiff also claimed that defendant was responsible for construction problems and delays that put the project behind schedule and threatened plaintiff's ability to fulfill its obligations to supply auto parts to General Motors.

Plaintiff subsequently submitted to defendant a Demand for Arbitration setting forth the following issues which

it sought to have resolved by arbitration: the amount due on the contract; breach of contract; construction defects; roofing problems; warranty claims; and patent and trade secret matters. Defendant refused the demand for arbitration, and plaintiff responded by filing suit in district court seeking to compel arbitration of the above issues and also seeking damages for tortious interference with business relationships and slander of title. Defendant then sought a stay of arbitration and entered counter-claims for breach of contract, unjust enrichment, fraudulent misrepresentation, breach of implied warranty, foreclosure of construction lien, and slander.

In a subsequent motion requesting determination of arbitrable disputes, defendant argued that only narrow issues were subject to arbitration under the parties' agreement. The district court agreed with plaintiff however, that "the arbitration provisions cover all disputes which arise from the contract." The district court found nonarbitrable only the issues of slander and tortious interference with business.

The parties proceeded to argue their claims before a panel of arbitrators, and in a one-page order containing no indi-

cation of the panel's reasoning, the arbitrators issued a "net award" in favor of plaintiff for just over $3 million. From the district court's order confirming the arbitration award and rejecting defendant's motion to vacate, this appeal followed.

II. DISCUSSION

Section 2 of the Federal Arbitration Act instructs courts that a "written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable." Further,

> arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to so submit. . . . This axiom recognizes the fact that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration.

Roney & Co. v. Kassab, 981 F.2d 894, 897

(1992) (quoting *AT&T Technologies, Inc. v. Communication Workers of America*. 475 U.S. 643, 648-49 (1986)). The duty to arbitrate is limited by the scope of the arbitration clause contained in the parties' agreement, and interpretation of the scope of an arbitration clause is a matter of law reviewed de novo by this court. *See Wiepking v. Prudential-Bache Sec., Inc.*, 940 F.2d 996, 998 (6th Cir. 1991). When disputes the parties did not agree to arbitrate are resolved by a panel of arbitrators, the panel has exceeded its power, and we may vacate the award pursuant to 9 U.S.C. § 10(a)(4).

In this case. defendant asserts that the district court erred in interpreting the four arbitration clauses contained in the parties' agreements as covering "all disputes which arise from the contract" and compelling defendant to arbitrate nonarbitrable disputes. Before we can reach this issue, however, we must first address defendant's argument that whatever the scope of the arbitration clauses, only disputes arising out of the Cost-Plus agreement can be submitted to arbitration.

Defendant contends that the several agreements executed by the parties were

separate contracts, and the arbitration clauses are found only in the Cost-Plus agreement. We note, however, that the Cost-Plus agreement and the Guaranteed Maximum Cost agreement were executed on the same day and by the same people, and both were back-dated to the same effective date. In addition, the Guaranteed Maximum Cost agreement speaks of "this project" and the "main contract," an obvious reference to the more substantial Cost-Plus agreement.

"When deciding whether the parties agreed to arbitrate a certain matter . . . , courts generally . . . should apply ordinary state-law principles that govern the formation of contracts." *First Options of Chicago v. Kaplan*, 314 U.S. _, 115 S. Ct. 1920, 1924 (1995). Michigan law governs the agreements at issue here. In *Sawyer v. Arum*, 690 F.2d 590, 592 n.1 (6th Cir. 1982), this court stated the general rule in Michigan that "in the absence of anything to indicate a contrary interpretation, instruments executed at the same time by the same parties, for the same purpose and in the course of the same transaction will be read together, it being said that they are, in the eye of the law, one instrument." As each element of this test

is met under the facts of this case, and because defendant offers no evidence other than a conclusory statement that the agreements were intended to be separate agreements, we construe the agreements as one contract. Therefore, the arbitration clauses contained in the Cost-Plus agreement apply to the Guaranteed Maximum Cost agreement, as well as to the other agreements entered into by the parties concerning the project.

Returning now to the issue on the scope of the arbitration clauses, plaintiff argues that the parties agreed to submit all contract issues to arbotration. Defendant responds that the parties agreed only to submit certain narrow issues to arbitration. It argues that the district court's order permitted the arbitrators to resolve issues of contract interpretation, and that as a result the arbitrators denied defendant the protection of the contract's consequential damages provision and obligated it to assume the costs of plaintiff's numerous Owner's Change Requests.

Several principles guide the determination of which disputes are arbitrable. The general rule is that a party cannot be forced to arbitrate any dispute that it has not obligated itself by

contract to submit to arbitration. *United Steelworkers of America v. Mead Corp.*, 21 F.3d 128, 131 (6th Cir. 1994). Where the contract contains an arbitration clause, there is a general presumption of arbitrability, and any doubts are to be resolved in favor of arbitration "unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute." *Id.* (quoting *AT&T Technologies. Inc.*, 475 U.S. at 650). Where the arbitration clause is broad, only an express provision excluding a specific dispute, or "the most forceful evidence of a purpose to exclude the claim from arbitration," will remove the dispute from consideration by the arbitrators. *Id.*

The parties agreement contains four arbitration clauses, three of which are very narrow in focus. Section E, "Scope of the Work-Procurement," sends to arbitration disputes over bid prices when defendant is the sole-bidder. Section E, "Instructions to Bidders," provides that disputes over what is included in a bid price are arbitrable. Section I, "Project Price," submits to arbitration disputes over costs for modifications that fall outside the scope of the project. These

three clauses are narrow in focus, and "it may be said with positive assurance that the arbitration clause[s are] not susceptible of an interpretation that covers" all issues arising under the contract to build the paint finishing plant.

Paragraph 26 of the General Conditions of the Cost-Plus agreement contains the agreement's fourth arbitration clause and reads in pertinent part:

> Any questions in dispute arising from these Drawings or Specifications or the progress of the work incapable of being promptly settled by Vemco and Flakt shall be submitted to arbitration. . . .

Plaintiff argues that this is a broad arbitration clause, and because there are no provisions excluding particular disputes from its sweep, the clause covers any disputes arising from the contract. We disagree. We have consistently construed as broad those clauses which send to arbitration virtually all controversies arising under an agreement; paragraph 26 does not purport to have such a wide sweep. *E.g.*, *Mead Corp.*, 21 F.3d at 132 (providing for arbitration of

"grievances charging that the Company has violated this Agreement and involving the interpretation of, or compliance with, this Agreement"); *Local 670 v. International*, 822 F.2d 613, 617 (6th Cir. 1987), *cert. denied*, 484 U.S. 1019 (1988) (sending to arbitration questions "concerning the meaning, interpretation, scope, or application" of the parties' agreement): *Cincinnati Gas & Elec. Co. v. Benjamin F. Shaw Co.*, 706 F.2d 155, 160 (6th Cir. 1983) (providing that "[a]ny controversy or claim arising out of this Agreement . . . shall be determined by arbitration. . . ."). Nor is the parties' agreement broad like the American Arbitration Association's standard arbitration clause which provides, "Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbotration." Paragraph 26 is not susceptible to an interpretation that it covers all disputes arising under the contract.

In sum, although the parties' agreement contains several arbitration clauses, none is so broad as to support the construction urged by plaintiff, i.e., that the parties agreed to submit to arbitration all of their disputes. Surely these clauses would not support

requiring arbitration of disputes over the agreement's requirement that the parties enter into a separate trade secret agreement, that defendant pay any and all relevant royalty fees, or that defendant procure adequate workers' compensation insurance.

We hesitate, however, to expressly delineate those disputes that are arbitrable because discerning the intention of the parties with respect to the scope of the arbitration clauses requires factual findings the district court has yet to make. For example, whether the parties intended paragraph 26's reference to "progress of work" to include quality of work as well as pace of work cannot be determined without further factual findings. Nevertheless, we agree with defendant that two issues in particular are not arbitrable. The first concerns plaintiff's argument that it agreed to limit defendant's liability for consequential damages in exchange for a limited warranty, and that if defendant violated the warranty, the consequential damages provision dropped from the contract. The second concerns plaintiff's argument that Owner's Change Requests fall within the $15 million cost cap. These issues require examination of the terms and conditions of the parties' agreement,

and, its scope; none of the arbitration clauses is broad enough to authorize an arbitration panel to perform this function. These are issues the district court should have decided.

This case has a long history, and we recognize that a decision to vacate the arbitration award will only add to that history. Unfortunately, the record indicates that the arbitrators likely resolved issues the parties did not agree to arbitrate, and that this resulted in an award for plaintiff that consisted of significant damages the arbitrators were without authority to assess against defendant.[1] For this reason, we reluctantly

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[1]We are particularly concerned with the parties's dispute over the application of the consequential damages provision. In the Conclusions of Law plaintiff submitted to the arbitration panel, plaintiff stated that it incurred $2,611,665 in "out-of-pocket costs" and $3,393,560 in "excess plant costs" due to defendant's behavior. Plaintiff then argued that because defendant failed to live up to its warranty obligation, "all limitations on consequential damages are barred." Finally, plaintiff stated to the panel: "To the extent that damages for Vemco's excess plant costs are deemed to be *consequential*, the contractual limitation of damages in this case does not preclude recovery of those damages." (emphasis added). Hence, plaintiff included

vacate the arbitration award, and we remand to the district court for a determination of arbitrable issues.

Finally, and contrary to plaintiff's assertions, defendant and its surety Federal did not waive their right to appeal by arguing their claims before the arbitration panel. Defendant and Federal requested a determination of arbitrable issues in the district court. They then abided by the district court's determination that all but two issues were arbitrable. "This is not a situation where [parties] consented to arbitration and are now seeking a second bite at the apple." *Wiepking*, 940 F.2d at 999.

III. CONCLUSION

The arbitration award is **vacated** and this case is **remanded** to the district court for proceedings consistent with this opinion.

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consequential damages in estimating its "excess plant costs," and it is likely the panel award plaintiff consequential damages in its "net award" of $3,111,422.44 because this amount exceeds the $2.6 million plaintiff claimed as out-of-pocket
costs.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ORDER

Case No. 94-1016: 94-1506

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ORDER

VEMCO, INC.,
a Michigan corporation;

Plaintiff - Appellee

FEDERAL INSURANCE COMPANY,
a New Jersey corporation

Plaintiff - Appellant

v.

FLAKT, INC.,
a Delaware corporation

Defendant - Appellant

v.

JAMES A. SCHUTZ, et al.;

Defendant

THOMAS J. KELLY, in
his capacity as
individual collateral
agent on behalf of

The New York Life Insurance Company and Aid Association for Lutherans; SECURITY PACIFIC NATIONAL TRUST COMPANY (NEW YORK), a national banking association, in its capacity as corporate collateral agent on behalf of The New York Life Insurance Company and Aid Associations for Lutherans; NEW YORK LIFE INSURANCE COMPANY, a New York corporation; AID ASSOCIATION FOR LUTHERANS, a fraternal benefit society organized under the laws of the State of Wisconsin

Defendants - Appellees

BEFORE: **KRUPANSKY**, **RYAN** and **NORRIS**;
Circuit Judges.

Upon consideration of the petition for rehearing filed by the appellee,

It is **ORDERED** that the petition for rehearing be, and it hereby is, **DENIED.**

ENTERED BY ORDER OF THE COUNSEL
/s/ Leonard Green, Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

TEMPORARY RESTRAINING ORDER

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC.,
a Michigan corporation,
Plaintiff,

Case No:88-40331
Honorable

-vs-

FLAKT, INC.,
a Delaware corporation,
Defendant.

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JIMM F. WHITE (P22256)
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TEMPORARY RESTRAINING ORDER

At a session of said Court held in the Federal Building, Flint, Michigan on September 9, 1988

PRESENT: Honorable:_____
U.S. District Judge

This cause coming on to be heard on the Motion of Plaintiff, VEMCO, INC., for a Temporary Restraining Order; and the Court having reviewed the Verified Complaint herein, together with the accompanying affidavits and the Motion For Temporary Restraining Order presented by counsel for Plaintiff, and it appearing that Plaintiff and Defendant entered into a Contract requiring arbitration of disputes under the Contract and requiring Defendant FLAKT, INC., to appoint an arbitrator and it further appearing to the Court that pursuant to the Contract that Defendant FLAKT, INC. is required to deliver plans and specifications for the VEMCO paint plant in Grand Blanc, Michigan to VEMCO; and it further appearing that the parties, in entering into the Contract, contemplated that in the event of a dispute, such dispute would be resolved . . . by arbitration, but that such arbitration would not delay performance by FLAKT, INC. under the Contract; and it further appearing that VEMCO will suffer irreversible and irreparable damage in terms of laid off employees, loss of business reputation with General Motors Corporation, severe dislocation to the work force of the State of Michigan, and damages to General Motors Corporation in an amount leading to its demise, and it further appearing

that Plaintiff's attorney has given notice to Defendants's counsel of this hearing, the Court finds that Plaintiff will suffer irreparable injury if this Temporary Restraining Order is not issued,

IT IS HEREBY ORDERED, that Defendant FLAKT, INC. a Delaware corporation, its officers, agents, employees, servants, attorneys, and those in active concert or participation with them be and they hereby ordered to proceed expeditiously with the arbitration proceeding in all its aspects, including the naming of its designated arbitrator within 24 hours of the filing of this suit, or in default thereof the Court order the appointment of the second and third arbitrators from among a list of American Arbitration Association arbitrators acceptable to the Court and VEMCO; and in addition to turn over the VEMCO all plans, specifications, drawings, sepias, blueprints, manuals and other documents in its possession or under its control relating in any way to the paint finishing project in Grand Blanc, Michigan.

IT IS FURTHER ORDERED that Plaintiff not be required to post security since Plaintiff is merely seeking to maintain the status quo by attempting to enforce

the arbitration agreement and the obligation to deliver plans and specifications for its paint plant in Grand Blanc, Michigan, and for the further reason that Defendant will not be harmed by the issuance of this Order.

IT IS FURTHER ORDERED that service of copy of this Order, the Verified Complaint, Motion For Preliminary Injunction shall be made upon Defendant on or before September 14, 1988.

IT IS FURTHER ORDERED that a hearing on Plaintiff's Motion For Preliminary Injunction shall be heard by this Court on September 19, 1988 at 2:00 p.m. o'clock in the _.m.

IT IS FURTHER. ORDERED that this Temporary Restraining Order shall expire at 5:00 p.m. on September 19, 1988, or upon further order of this Court.

_____

United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

OPINION AND ORDER

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION - FLINT

VEMCO, INC.,

Plaintiff,

v.

CIVIL ACTION
NO: 88-CV-40331-FL

FLAKT, INC.,

Defendant.

MEMORANDUM OPINION AND ORDER

Before the Court is defendants and counter-plaintiffs Flakt, Inc.'s and Federal Insurance Company's Motion for an Order Determining and Staying Arbitrable Claims. The motion to stay is GRANTED in part and DENIED part. This suit arises from agreements between the parties regarding the design, fabrication and installation of a paint finishing system at one of plaintiff's manufacturing facilities. On September 9, 1988, this Court issued a temporary restraining order ("TRO") compelling defendant Flakt to deliver to plaintiff Vemco, Inc. ("Vemco") drawings and manuals for the paint finishing system. The TRO also required Flakt to proceed with arbitration. The TRO, however, did not define the issues which the parties are

required to arbitrate. Flakt and Federal Insurance Co.[1] now bring this motion requesting an order to determine which disputes are arbitrable, and to stay arbitration of those issues pending the resolution of all nonarbitrable issues raised in the complaint and counterclaim.

At issue are three agreements: the July 24, 1987 contract between Vemco and Flakt for the design, fabrication and installation of the system referred to as "Agreement"; an agreement regarding the installation of a VOC incineration system ("VOC"); and the Guaranteed Maximum Cost Agreement. Vemco filed a Demand for Arbitration and in it set forth the following issues which it contends are to be resolved by arbitration: the amount due on contract; breach of contract; construction defects; roofing problems; warranty claims; and patent and trade secret matters. Flakt argues that only those issues made arbitrable by agreement of the parties may be referred to arbitration. Flakt contends that the arbitration provisions of the Agreement were intended to address only minor disputes. Flakt argues that the arbitration provisions are narrow,

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[1]Flakt and Federal Insurance co. Will be jointly referred to as "Flakt."

limited in scope and apply to few, if any, of the disputes between Vemco and Flakt, and none of the claims involving third parties. In addition, Flakt argues that Vemco has waived its right to arbitrate any arbitrable claims.

There are two arbitration statutes which arguably apply to the case at hand, the Federal Arbitration Act and the Michigan counterpart, M.C.L.A. 4001 et seq. The Federal Arbitration Act, 9 U.S.C. § 1 et seq., applies only to claims which arise from interstate commerce. Flakt asserts that the federal act is not applicable in this case because the claims at issue do not involve interstate commerce. Flakt notes that the plaintiff's principal place of business and the plant at issue are located in Michigan. Flakt's paint line division's principal place of business is also located in Michigan. The Court notes, however, that Flakt Inc. is a Delaware corporation with its principal place of business in the state of Georgia. (Docket Entry #1, Complaint p. 2). Federal Insurance Co. is a New Jersey Corporation. Finally, the Vemco plant is a supplier to the General Motors Corporation's Lake Orion plant. (Docket Entry 1, ¶ 29(b)).

The Federal Arbitration Act rests on the authority of Congress to enact substantive rules under the Commerce Clause. Southland Corp. v. Keating, 465 U.S. 1, 104 S.Ct. 852 (1984). The requirement that the contract evidence a transaction involving commerce is to be construed broadly. Snyder v. Smith, 736 F.2d 409 (7th Cir. 1984), cert. denied, 469 U.S. 1037 (1984). Citizens of different states performing contractual obligations in one of those states are considered to be engaged in a "contract involving commerce" for purposes of the federal act. Mesa Operating Ltd. Partnership v. Louisiana Insterstate Gas Corp., 797 F.2d 238 (5th Cir. 1986). The Act itself sets forth a clear policy of arbitration unless the arbitration provision is not part of a contract evidencing interstate commerce. Perry v. Thomas, 482 U.S. 483, 107 S.Ct. 2520 (1987). For these reasons, the Court finds that the federal act applies to the contract at issue.

For arbitration to proceed under the federal act, three elements are necessary. There must be an agreement to arbitrate and arbitrable claims, and the right to arbitrate must not have been waived. Flakt contends that Vemco has not shown that arbitrable issues exist and,

further, that Vemco has waived its right to arbitration.

Under the assumption that the federal act did not apply, Flakt argued in its brief that waiver has occurred under state law. Flakt argues that Vemco waived its right to arbitration by actively participating in litigation involving the same issues that otherwise would be arbitrable. Flakt asserts that Vemco noticed depositions and filed a motion for summary judgment in a related state case, and that these actions are sufficient indicia that Vemco was not relying on the arbitration provisions.

The requirements for waiver under the federal act mirror those for the state. An agreement to arbitrate may be waived by the actions of a party if those actions are completely inconsistent with any reliance on the arbitration agreement. Germany v. River Terminal Ry Co., 477 F.2d 546 (6th Cir. 1973). Suing or participating in a suit can constitute waiver of a right to arbitration, however, the burden on the party seeking to prove waiver of a contractual right to arbitration is a heavy one. Id. Waiver will only be found when the party seeking arbitration substantially invokes the judicial process to the detriment or

prejudice of the other party. Price v. Drexel Burnham Lambert, Inc., 791 F.2d 1156 (5th Cir. 1986). The extent of the litigation must be so substantial that to permit arbitration after the judicial process has been invoked would cause prejudice. Delay alone, without a showing of prejudice will not suffice to constitute a waiver. Maxum Foundations v. Salus Coro., 779 F.2d 974 (4th Cir. 1985) (The party seeking arbitration does not lose its contractual right by prudently pursuing discovery in the face of court-ordered deadlines.) Where only a minimal amount of discovery has been conducted, the Court should not infer waiver based upon prejudice to the party opposing arbitration absent a showing of prejudice. Tenneco Resins v. Davy Internat'l., 770 F.2d 416 (5th Cir. 1985).

There is no rigid rule as to what constitutes waiver of an arbitration agreement. The issue of waiver depends on the facts of the case. Ohio-Sealy Mattress Mfg. Co. v. Kaplan, 712 F.2d 270 (7th Cir. 1983), cert. denied, 464 U.S. 1002 (1983). Relevant factors in determining whether a party to an arbitration agreement has waived its arbitration right include whether the party has invoked the jurisdiction of the

court without asking for a stay of the proceedings to pursue arbitration, whether important intervening steps, such as judicial discovery procedures not available in arbitration, have taken place, and whether the other party was affected, misled, or prejudiced by the delay. Reid Burton Const. v. Carpenters Dist. Council of Southern Colorado, 614 F.2d 698 (10th Cir. 1980), cert. denied, 449 U.S. 824 (1980). Participating in litigation is not enough to effectuate a waiver. Carchich v. Rederi A/B Nordie, 389 F.2d 692 (2d Cir. 1968). Here, Vemco noticed a deposition but the deposition was not taken. As Flakt has not shown that there has been substantial participation in litigation which has caused delay and/or undue prejudice, the contractual right to arbitration has not been waived.

Flakt contends that even if Vemco has not waived its right to arbitration, the arbitration provisions in question require only specific issues to be arbitrated. Flakt contends that the arbitration provisions were intended to cover only minor disputes. As this is a major monetary dispute involving breach of the agreement, Flakt contends that the arbitration provisions do not apply.

In addition, unless an agreement with an arbitration provision is clear that the parties intended some matters not to be arbitrated, and it is clear which issues fall into the nonarbitrable category, then all doubts should be resolved in favor of arbitration. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 105 S.Ct. 1238, 1240-42 (1985). The parties agree that Vemco's claims for slander and tortious interference with contractual relationships and Flakt's claim of slander are not arbitrable. Flakt contends that the remaining issues in the complaint and counterclaim are left for the Court to delineate into arbitrable and nonarbitrable categories.

The remaining issues are as follows: Vemco's breach of warranty claim; Flakt's breach of contract claim; Flakt's unjust enrichment claim; Flakt's breach of the VOC contract claim; Flakt's quantum meruit claim; Flakt's warranty obligations; Flakt's obligations under the GMC Agreement and the Repurchase Agreement; trade secrets: Flakt's claim of misrepresentation by James A. Schultz, individually: Flakt's claim of breach of implied warranty by James A. Schultz, individually; Flakt's claim under M.C.L.A. § 570.1101 to forclose the construction lien; and Flakt's claim of

misrepresentations by Vemco as to the financial arrangement for additional work performed. Flakt contends that the only arbitrable claims are those that involve a determination of the costs of extras not approved by Vemco and those that arise from the drawings and specificaitons. Vemco, on the other hand, contends that the arbitration provisions cover all the disputes which arise from the contract. This approach would make nonarbitrable issues that are related to the actions of the parties outside the contract. The Court agrees with Vemco and finds that the arbitration provisions cover all disputes which arise from the contract.[2] The issues that remain all

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[2]Paragraph 26 of the General Conditions of the Agreement reads in pertinent part:

> Any questions in dispute arising from these Drawings or Specifications or the progress of the work incapable of being promptly settled by Vemco and Flakt shall be submitted to arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association; and judgment upon the award rendered may be entered in any Court having jurisdiction thereof.

arise out of the same commercial transaction, the Vemco-Flakt Agreement regarding the paint finishing system, and they are intertwined legally and factually.

Flakt seeks a stay of the arbitration until the Court can rule on the nonarbitrable issues. The stay is DENIED. The Federal Arbitration Act requires that this Court enforce the parties bargain to arbitrate. Flakt's motion is GRANTED in that the Court has delineated arbitrable and nonarbitrable

---

Arbitration is referred to in other sections of the Agreement. In Section I of the Agreement the parties agreed to arbitration. The pertinent landguage reads, "All disputes over cost for modifications outside the scope of the Project will be submitted to arbitration as laid out in the General Conditions." Section E of the Agreement regarding the scope of work procurement reads: "However, Vemco retains the right at its discretion to request Flakt be a sole bidder for certain equipment. These will also be estimated by mutually agreed upon third party, and in case of the dispute resolution procedures in the 'general conditions.'" Section E Instructions to Bidders reads, "Extras must clearly be outside the intended scope of the subcontract, and must be approved by Vemco or otherwise submitted to arbitration between Vemco and Flakt."

issues. The non-arbitrable issues are Vemco and Flakt's claims for slander and Vemco's claim for tortious interference with contractual relationships. All of the remaining claims the Court has found to be based on and arising out of the contracts between the parties and are hereby referred to arbitration.

SO ORDERED.

Dated: 3/22/89 /s/ Stewart A. Newblatt
STEWART A. NEWBLATT
United States District Judge

CERTIFICATION OF SERVICE

UNITED STATES	)	
OF AMERICA	)	Case No.:
	) ss	88-40331
EASTERN DISTRICT	)	
OF MICHIGAN	)	

I, the underaigned, hereby certify that I have on the 23d day of March, 1989, mailed a copy of the Memorandum Opinion and Order in the foregoing cause, pursuant to Rule 77(d), Fed.R.Civ.P., to the following persons at the addresses given:

Jimm F. White, Esq.
255 S. Woodward
Suite 205
Birmingham, MI 48011

Timothy D. Wittlinger, Esq.
100 Renaissance Center
32d Floor
Detroit, MI 48243

Raymond C. McVeigh, Esq.
Denis C. Monahan, Esq.
2400 First National Bldg.
Detroit, MI 48226

M. Allen Robb, Esq.
444 Church St.
Suite 200
Flint, MI 48502

Gilbert E. Gove, Esq.
Allen Schwartz, Esq.
Susan T. Cannell, Esq.
2500 Comerica Bldg.
Detroit, MI 48226

/s/ Colette J. Lehoux
Colette J. Lehoux, Secretary to
Stewart A. Newblatt
United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

ORDER

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION - FLINT

VEMCO, INC.,
a Michigan corporation,

Plaintiff and
Counter-Defendant,

v.

CIVIL ACTION
#88-CV-40331-FL

FLAKT, INC.,
a Delaware corporation,

Defendant and
Counter-Plaintiff;

Etc.

ORDER CONFIRMING ARBITRATION AWARD;
GRANTING PARTIAL FINAL JUDGMENT
TO PLAINTIFF; AND GRANTING
SUMMARY JUDGMENT TO COUNTER-DEFENDANTS

Pending before the Court are cross motions regarding the amended arbitration award of September 1, 1993. Vemco seeks confirmation of the award. Also, Counter-Defendants, the New York, Life Insurance Co., Aid Association for Lutherans, Security Pacific National Trust Co., and Thomas J. Kelly have filed a motion for summary judgment on Flakt's counterclaim. Flakt seeks the arbitrators' award vacated.

1. The Court confirms the award, and orders the clerk to issue a partial judgment for VEMCO against FLAKT and FEDERAL INSURANCE CO., jointly and severally, in the amount of $3,111,422.44 plus interest at the rate specified in 28 U.S.C. § 1961 from the date of June 15, 1993 (the date of the original arbitral award).

Flakt seeks the arbitration order vacated on the grounds that this Court lacked authority to send to arbitration all of the issues that it did send. Flakt makes no argument however that the arbitrators decided issues beyond the scope of this Court's orders of March 22, 1989 and July 11, 1989. This Court must deny what is, in effect, a motion by Flakt for reconsideration filed four years late.

Since the arbitrators issued a decision based upon the issues that this Court had sent to arbitration, they did not exceed their authority. If this Court's orders of 1989 were incorrect, then Flakt's remedy lies in an appeal.

2. Vemco also seeks this Court to find that Federal Insurance Company, another party to this case, see Dkt. #10, is liable on the judgment from the arbitration. On September 1, 1993, the arbi-

trators issued an amended order naming Federal as jointly and severerally liable. Federal had issued a performance bond to Vemco on behalf of Flakt, and Federal agreed to be bound by the arbitration. Plaintiff's Ex. C, in Motion for Confirmation. Federal has presented no reason why it should not be so bound.

3. The Counter Defendants seek summary judgment on Flakt's and Federal's counterclaims since they were also referred to arbitration. Order of March 22, 1989. The Arbitrators' Award considered Flakt's counterclaims and made a net award to Vemco. Summary Judgment is therefore GRANTED to N.Y. Life Insurance Co., Aid Assoc. for Lutherans, Security Pacific National Trust Co., and Thomas J. Kelly.

4. Flakt has a construction lien and lis pendens against Vemco's property stemming from its counterclaim. The basis for these liens is Flakt's counterclaim, which has now been decided. Therefore, these liens are DISSOLVED.

5. Several issues in this case had been stayed pending the arbitration. This Court now removes the stay and order that a FINAL PRETRIAL CONFERENCE be set for December 22, 1993 at 1:30 p.m.. A

proposed joint final pretrial statement, in accordance with this Court's policies, must be filed by December 17, 1993.

SO ORDERED.

Date: 11/10/93 /s/ Stewart A. Newblatt
STEWART A. NEWBLATT
U.S. District Judge

CERTIFICATION OF SERVICE

UNITED STATES OF AMERICA)
) SS
EASTERN DISTRICT OF MICHIGAN)

I, the undersigned, hereby certify that I have on the 10th day of November, 1993, mailed a copy of the ORDER in the foregoing cause, pursuant to Rule 77(d), Fed.R.Civ.P., to the following persons at the addresses given:

Jimm F. White
Julie D. Abear
KEYWELL AND ROSENFELD
2301 W. Big Beaver Road, Suite 600
Troy MI 48084-3329

Leroy L. Asher, Jr.
MILLER, CANFIELD, PADDOCK & STONE
150 W. Jefferson, Suite 2500
Detroit MI 48226

Denis C. Monahan
Raymond C. McVeigh
MAGER, MONAHAN, DONALDSON & ALBER
2400 First National Building
Detroit MI 48226

Patrick M. Kirby
PATRICK M. KIRBY, P.C.
1335 S. Linden Road
Flint MI 48504-4149

/s/ Colette J. Lehoux
Colette J. Lehoux, Secretary to
Stewart A. Newblatt
United States District Judge

APPENDIX F

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

JUDGMENT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC.,
a Michigan corporation,

Plaintiff and
Counter-Defendant,

v.

Civil Action
No. 88CV40331FL

Judge Stewart
A. Newblatt
(P 18257)

FLAKT, INC.,
a Delaware corporation,

Defendant and
Counter-Plaintiff;

Etc.

JIMM F. WHITE (P22256)
JULIE D. ABEAR (P41065)
Keywell & Rosenfeld
Attorneys for Vemco
2301 W. Big Beaver Road, Suite 600
Troy, Michigan 48084-3329
(313) 649-3200

GILBERT E. GOVE (P14240)
LEROY L. ASHER, JR. (P37972)
Miller Canfield Paddock and Stone
Attorneys for N.Y. Life, Aid Assoc.
for Lutherans, Security and Kelly
150 West Jefferson, Suite 2500
Detroit, MI 48226
(313) 963-6420

DENIS C. MONAHAN (P24172)
RAYMOND C. MCVEIGH (P33420)
JEFFREY M. FRANK (P46916)
Mager, Monahan, Donaldson
& Alber, P.C.
Attorneys for Flakt, et al.
2400 First National Building
Detroit, Michigan 48226
(313) 965-1700

PATRICK M. KIRBY (P23011)
Patrick M. Kirby, P.C.
Co-counsel for Flakt, et al.
1335 S. Linden Road, Suite G
Flint, MI 48504-4149
(313) 230-0833

PARTIAL FINAL JUDGMENT AND
RULE 54(b) CERTIFICATION

This Court by Order Confirming Arbitration Award; Granting Partial Final Judgment To Plaintiff; And Granting Summary Judgment To Counter-Defendants, dated November 10, 1993, and Order denying RECONSIDERATION, dated 4/6, 1994 (collectively the "Orders") confirmed an Amended Arbitration Award, dated Sep-

tember 1, 1993, in favor of Plaintiff, Vemco, Inc., and against the Defendants, Flakt, Inc. and Federal Insurance Company, jointly and severally, in the sum of $3,111,422.44 plus interest at the rate specified in 26 U.S.C. §1961 from the date of June 15, 1993 (the date of the original award:

This Court expressly determines pursuant to F. R. Civ. P. 54(b), that there is no just reason for delay in the entry of a final judgment as to the claims determined by those Orders, for the following reasons:

1. The Orders confirm an arbitration award that states that it is a net award including both claims by Vemco and counterclaims by Flakt. Vemco moved to confirm that award, and Flakt moved to vacate it. This Court confirmed that award pursuant to the Federal Arbitration Act, 9 U.S.C. 13, pursuant to which an arbitration award, upon confirmation, may be entered as a judgment.

2. The claims remaining to be determined in this action involve separate issues of law and questions of fact from the issues resolved in the Orders, which confirmed the Amended Arbitration Award.

3. The Orders also ordered that Flakt's construction lien and lis pendens against Vemco's property be dissolved, there being no just reason to delay the effect of those Orders and to release Vemco's property from those liens.

NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED, AND THIS COURT DIRECTS THE CLERK TO ENTER JUDGMENT AS FOLLOWS:

1. Plaintiff, Vemco, Inc., recover of and from the Defendants, Flakt, Inc. and Federal Insurance Company, jointly and severally, a Partial Final Judgment in the sum of $3,111,422.44, plus interest at the rate of 3.54% from June 15, 1993 on Count I of Vemco's Complaint, dated September 8, 1988, and Counts I, III, V, IX and XI of Flakt's and Federal's Counterclaim, dated September 22, 1988.

2. Summary Judgment is granted in favor of Counter-Defendants, N.Y. Life Insurance Co., Aid Association for Lutherans, Security Pacific National Trust Company and Thomas J. Kelly and against Flakt on Count IX of Flakt's and Federal's Counterclaim dated September 22, 1988.

3. The Construction Lien filed by Flakt, Inc. in Liber 2462, Pages 398-99, Genesee County Records, on August 8, 1982, and the Notice of Lis Pendens filed by Flakt in Mortgage Liber 2471, Pages 33-36, Genesee County Records, on September 27, 1988, relating to the real property described below, are hereby dissolved and discharged:

PARCEL A:

Part of the East ½ of Section 33, Township 6 North, Range 7 East Michigan Meridian, Township of Grand Blanc, Genesee County, Michigan described as follows:

Beginning at the East 1/4 Corner of said Section: Thence North 00 Degrees 08 Minutes 16 Seconds West (Assumed Bearing) 1000.38 Feet along the East Line of Section: Thence South 89 Degrees 24 Minutes 09 Seconds West 270.00 Feet; Thence South 00 Degrees 35 Minutes 51 Seconds East 100.00 Feet; Thence South 89 Degrees 24 Minutes 09 Seconds West 100.00 Feet; Thence North 00 Degrees 35 Minutes 51 Seconds West 100.00 Feet; Thence South 89 Degrees 24 Minutes 09 Seconds West 962.25 Feet; Thence South 08 Degrees 00 Minutes 38 Seconds East 994.10; Thence South 00 Degrees 04 Minutes 29 Sec-

onds East 315.53 Feet; Thence North 89 Degrees 24 Minutes 11 Seconds East 1331.32 Feet; Thence North 309.26 Feet along the East Line of said Section to the Point of Beginning. Subject to a 20.00 Foot Easement for water main purposes over, under, and across the following: Commencing at the East 1/4 Corner of said Section; Thence North 00 Degrees 08 Minutes 16 Seconds West (Assumed Bearing) 1000.38 Feet along the East Line of Section to the Point of Beginning: Thence South 89 Degrees 24 Minutes 09 Seconds West 270.00 Feet; Thence South 00 Degrees 35 Minutes 51 Seconds East 20.00 Feet; Thence South 89 Degrees 24 Minutes 09 Seconds West 269.85 Feet; Thence North 00 Degrees 08 Minutes 16 Seconds West 20.00 Feet to the Point of Beginning. Subject to a 66.00 Foot Easement for ingress and egress purposes over, under, and across the above described property. Said Easement being 33.00 Feet each side of the following described line: Commencing at the East 1/4 Corner of said Section: Thence North 00 Degrees 08 Minutes 16 Seconds West (Assumed Bearing) 672.98 Feet along the East Line of Section to the Point of Beginning; Thence South 89 Degrees 24 Minutes 09 Seconds West 226.24 Feet;

Thence 295.00 Feet along a Tangential Curve, concave to the North, having a radius of 313.00 feet and a Central Angle of 54 Degrees 00 Minutes 00 Seconds; Thence North 36 Degrees 35 Minutes 51 Seconds West 76.54 Feet; Thence North 53 Degrees 24 Minutes 09 Seconds East 45.94 Feet; Thence 73.83 Feet along a Tangential Curve, concave to the South, having a radius of 117.50 feet and a Central Angle of 36 Degrees 00 Minutes 00 Seconds; Thence North 89 Degrees 24 Minutes 09 Seconds East 50.84 Feet to the terminus of said line. The side lines of said easement are prolonged or shortened to terminate at the appropriate lines of the above-described property. Together with an subject to Covenants, Easements, and Restrictions of Record. Said Parcel contains 39.81 Acres.

4. Adjudication on Counts II and III of Vemco's Complaint, dated September 8, 1988, and Counts II, IV, VI, VII, VIII, and X of Flakt's and Federal Insurance Company's Counterclaim, dated September 22, 1988, are specifically reserved for future adjudication.

5. Vemco's request to defer the issue of costs, attorneys' fees and arbitration fees related to Arbitration

is denied as the Amended Arbitration Award did not allow Vemco any costs, attorneys' fees or arbitration fees related to Arbitration.

SO ORDERED.

/s/ Stewart A. Newblatt
STEWART A. NEWBLATT
United States District Judge

Dated: 04/06/94

APPENDIX G

CORRESPONDENCE BETWEEN COUNSEL

March 30, 1989

Denis C. Monahan
Mager, Monahan, Donaldson & Alber
2400 First National Building
Detroit, Michigan 48226

Re: Vemo, Inc. v.s. Flakt, Inc.

Dear Denis:

The following is my understanding of the agreements reached at the pre-hearing conference at the American Arbitration Association on March 23, 1989. I purpose to send a copy of this letter to the Tribunal Administrator for transmission to the arbitrators, but before I did so I wanted to give you the opportunity to advise me if any of the following does not comport with your understanding:

1) Both sides have submitted additional suggested names for the third arbitrator. Each side will notify the other of any names which are deemed unacceptable on or before Friday, March 31, 1989. If there are any names left on the list, the present arbitrators will select the third arbitrator from those remaining names.

2) If there are no names left on the list after the March 31, 1989 notification, the two current arbitrators will select the third arbitrator from all of the names previously suggested by either of the parties, without regard to the fact that some of those names have been previously eliminated by one or more of the parties. In this regard, each party

this regard, each party shall be free to challenge any of the names left on the list for cause, and in addition shall have one "pre-emptory challenge" as to any one additional name on the list. The two current arbitrators will resolve any disputes which arise in this regard.

3) Mr. Monahan will advise Mr. Wittlinger on or before March 31, 1989, whether the bonding company will agree to be bound by the decision of the arbitrators.

4) Concerning additional document discovery, both sides will circulate to the other side by March 31, 1989, a list of all additional documents requested. The respective parties will then comply with that request by furnishing the documents on or before April 17, 1989.

5) We have just received a decision from Judge Newblatt on the current pending issues before him. This opinion defines the scope of the arbitration. A copy is enclosed for the information of the arbitrators.

6) The issue of bifurcation of the arbitration hearing will be deferred to the next pre-hearing conference.

7) It is hoped that the arbitration might commence in the June-July-August period. The Tribunal Administrator will circulate a calendar to obtain available dates during that period.

8) It was decided that a transcript of the arbitration hearing will be made, with the costs to be divided between the parties.

9) It was decided that a "final joint pre-trial order" will be submitted to the arbitration panel 10 days

prior to the hearing date. Vemco will circulate an initial draft of this order to Flakt, and Flakt will have an opportunity to modify or supplement it before submission to the arbitration panel.

10) It was anticipated that the arbitration hearing will last approximately 3 weeks.

11) The next pre-hearing conference will occur on May 16, 1989, at the offices of the American Arbitration Association.

Please advise me immediately if you have any objection to my forwarding a copy of the above to the American Arbitration Association as an accurate summary of the March 23, 1989 conference.

Sincerely,

HILL LEWIS

Timothy D. Wittlinger

TDW:bd
Enclosure

March 31, 1989

TELECOPIED AND FIRST CLASS MAIL

Timothy W. Wittlinger, Esq.
Hill, Lewis
32nd Floor
100 Renaissance Center
Detroit, Michigan 48243

Re: In the matter of the Arbitration
Between Vemco, Inc. And Flakt, Inc.
Case No. 54-133-0152-88

Dear Mr. Wittlinger:

This letter is partially in response to your March 30, 1989 correspondence and also raises additional matters.

1. Third Arbitrator. On March 27, 1989, Flakt accepted the appointment of Mr. Robert G. Russell as the third arbitrator. Since Vemco has already indicated that it would accept Mr. Russell as the third arbitrator, presumably Mr. Russell will be the third arbitrator. As a part of further clarification, if Mr. Russell is unable or unwilling to serve as the third arbitrator, Flakt would consider Mr. Robert G. Cutler, Mr. Robert S. Krause, Mr. Michael Lewiston and Mr. Eugene Twichell. Mr. Irwin M. Alterman, Mr. Robert A. Fineman, Mr. Abba I. Friedman, Mr. Frank S. Galgan, Mr. Norman L. Lippitt, Mr. Stuart H. Teger, Mr. Eli Stanesa and Mr. Sheldon P. Winkelman are unacceptable.

If Mr. Russell is not the third arbitrator, it is correct that Mr. Reehil and Mr. Serlin will select the third from the remaining names.

2. Federal Insurance. Federal Insurance Company agrees that it will be bound by the arbitration proceedings as to those issues which are arbitrated. There may be separate issues relating solely to the surety bond which are not part of the arbitration.

3. Discovery of Documents. Flakt requests that Vemco produce all correspondence, books, records, documents, drawings, meeting minutes, status reports and other materials in Vemco's possession, or in the possession of Vemco's agents, concerning the Project for Flakt's review and copying.

The following categories are listed as specific examples and not as limitations:

a. Correspondence and other communications from Flakt to Vemco;

b. Correspondence and other communications from Vemco to Flakt;

c. Correspondence from Vemco to Flakt's and/or Vemco's subcontractors, suppliers and/or consultants, concerning the Project;

d. Correspondence and other communications from Vemco to Vemco's lenders concerning the Project;

e. Correspondence and other communications from Vemco to General Motors and any other of Vemco's customers or potential customers;

f. Vemco's production records concerning parts painted at the Project;

g. All drawings prepared by Vemco or for Vemco;

h. All of Vemco's budgets from 1987, 1988 and 1989;

I. All correspondence to and from Vemco and the Spohn Company and any other party concerning the roof;

j. All materials, proposals, quotes, etc. received from Durr Corporation or any other paint system contractor to install the Grand Blanc paint system;

k. All materials submitted to Kidder, Peabody & Co. Concerning the project financing and capital restructuring program for Venture Holdings Trust;

l. All insurance applications, appraisals, correspondence, etc. concerning the Paint system;

m. All checks, invoices, bills, etc. related to payments Vemco made

concerning the Paint System.

4. Depositions. In addition to the production of the above documents, Flakt would like to take the depositions of Mr. A. James Schutz, Mr. Daniel Scott, Ms. Ann K. Samuel and Vemco's expert witness.

Flakt is, of course, willing to allow Vemco to conduct depositions of Flakt's personnel.

5. Site Inspection. Flakt would also like access to the Project so that it may review the status of the Project and have its expert witness view the Project.

6. Dismissal of Patent & Trade Secret Claims. In your March 30, 1989 correspondence, you failed to include that Vemco has dismissed any claims concerning "Patent and Trade Secret matters" as set forth in Vemco's Demand For Arbitration.

7. Additional Parties To Arbitration. The Court's Memorandum Opinion and Order suggests that Flakt's claims against Mr. Schutz and Flakt's construction lien claim are to be arbitrated. Flakt is considering requesting the Court to reconsider, or at least clarify, these issues. If the Court did intend that these claims be arbitrated, we will have to consider how those additional parties will be made part of the arbitration proceeding. Since you represent Mr. Schutz, please acknowledge that Mr. Schutz will be bound by the arbitration.

8. Counterclaim. Since Judge Newblatt's Memorandum Opinion and Order requires arbitration of most of Flakt's claims (as set forth in the Counterclaim in Federal Court) Flakt will file a counterclaim in the

arbitration proceeding prior to the next pre-hearing conference.

If you have any questions, please call me.

Truly,

MAGER, MONAHAN,
DONALDSON & ALBER

Denis C. Monahan

DCM/sah

cc: Jerry Hermann, Esq.
Mr. Tom Mark
George D. Mercer, Esq.

April 14, 1989

Ms. Janice Holdinski
Tribunal Supervisor
American Arbitration Association
10 Oak Hollow
Suite 170
Southfield, Michigan 48034-7405

Re: VEMCO, INC. and FLAKT, INC. (Alpha Division) and FEDERAL INSURANCE COMPANY; Case No. 54 133 0152 88

Dear Ms. Holdinski:

This letter is in response to Mr. White's letter dated March 31, 1989.

Mr. White nominated Robert G. Russell as a candidate for the third arbitrator position. At the March 23, 1989 Pre-hearing Conference, Vemco reaffirmed that Mr. Russell was acceptable to it. Vemco should not be permitted to raise an objection to an arbitrator it nominated after Flakt agreed to accept the arbitrator.

Furthermore, it has been Flakt's position that Federal Insurance is not even a proper party to the arbitration proceeding because Federal Insurance had not agreed to arbitrate any dispute with Vemco. Federal Insurance subsequently agreed to be bound by the arbitration concerning non-surety issues. Flakt is obligated to indemnify Federal Insurance from any claim arising out

of the bond, and, as a practical matter, Federal Insurance does not even need to be named in the arbitration proceeding. Therefore, Federal Insurance should not be named in the arbitration proceeding and should, in effect, be treated as any other insurance company in a litigation matter involving its insured.

Therefore, Flakt would request that Federal Insurance's name be removed from the arbitration proceedings and that Mr. Russell continue to serve as the third arbitrator.

If Mr. Russell is removed from the panel, then Flakt should be entitled to exercise its one "peremptory" challenge to the third arbitrator to be named by Mr. Serlin and Mr. Reehil. The remaining candidates appear to be Messrs. Cutler, Krause and Lewiston.

Truly,

MAGER, MONAHAN,
DONALDSON & ALBER

Denis C. Monahan

DCM/sah

cc: Mr. Jimm F. White
Jerry Herrmann, Esq.
Mr. Tom Mark
George D. Mercer, Esq.

May 1, 1989

Denis C. Monahan
Mager, Monahan, Donaldson & Alber
2400 First National Building
Detroit, Michigan 48226

Re: Vemco, Inc. V.s.. Flakt, Inc.

Dear Denis:

The following is my understanding of the agreements reached at the pre-hearing conference at the American Arbitration Association on March 23, 1989 as well as subsequently.

1) The third arbitrator will be Mr. Robert G. Russell.

2) The bonding company, Federal Insurance Co., will agree to be bound by the decision of the arbitrators.

3) Concerning additional document discovery, both sides have circulated to the other side a list of all additional documents requested. The respective parties will comply with that request by furnishing the documents as soon as practical.

4) Judge Newblatt's decision will govern the course of the arbitration. A motion to clarify the opinion is pending but shall not be grounds for any delay of the arbitration hearing.

5) The issue of bifurcation of the arbitration hearing will be deferred to the next pre-hearing conference.

6) It is hoped that the arbitration might commence in the June-July-August period. The Tribunal Administrator has circulated a calendar to obtain available dates during that period.

7) It was decided that a transcript of the arbitration hearing will be made, with the costs to be divided between the parties.

8) It was decided that a "final joint pre-trial order" will be submitted to the arbitration panel 10 days prior to the hearing date. Vemco will circulate an initial draft of this order to Flakt, and Flakt will have an opportunity to modify or supplement it before submission to the arbitration panel.

9) It was anticipated that the arbitration hearing will last approximately 3 weeks.

10) The next pre-hearing conference will occur on May 16, 1989, at the offices of the American Arbitration Association.

Please advise me immediately if you have any disagreement with any of the above points, so that I can prepare an appropriate agenda for the May 16, 1989 conference.

Sincerely,

HILL LEWIS

Timothy D. Wittlinger

May 3, 1989

VIA TELECOPIER - 352-3147

Ms. Janice Holdinski, Tribunal Supervisor
American Arbitration Association
10 Oak Hollow, Suite 170
Southfield, Michigan 48034-7405

Re: Case No. 54-133-0152-88
Vemco, Inc. And Flakt, Inc.
(Alpha Division) and
Federal Insurance Company

Dear Ms. Holdinski:

Enclosed is your June/July calendar, which we have indicated the available and unavailable dates.

Regarding Mr. Monahan's April 14, 1989 correspondence, we previously indicated that Mr. Russell would be acceptable if his firm no longer represents Federal Insurance Company. We understand that Mr. Russell's firm does not represent Federal Insurance Company on any open files. Accordingly, Mr. Russell is an acceptable third arbitrator. Naturally, his firm will not accept any new cases for Federal Insurance Company during the course of this arbitration.

Since Federal Insurance Company has agreed to be bound by the arbitration proceeding concerning non-surety matters, Federal Insurance Company should remain in the arbitration. The American Arbitration Association and Mr. Monahan should be aware that Vemco may assert that

Federal Insurance Company is or should be bound by the arbitration proceeding concerning surety issues as well as non-surety issues. That will be the subject of direct correspondence with Mr. Monahan.

Very truly yours,

HILL LEWIS

Jimm F. White

JFW:she
Enclosure
cc: Denis C. Monahan, Esq.
bcc: Timothy D. Wittlinger, Esq.
Michael Torakis

May 4, 1989

Denis C. Monahan, Esq.
Mager, Monahan, Donaldson & Alber
2400 First National Building
Detroit, Michigan 48226

Re: Vemco, Inc. and Flakt, Inc.
(Alpha Division) and
Federal Insurance Company
AAA No. 54-133-0152-88

Dear Mr. Monahan:

Enclosed is a copy of our correspondence to the American Arbitration Association regarding the calendar and confirmation of Mr. Russell's appointment.

We request that Federal Insurance Company agree to be bound in the arbitration on all issues, not merely non-surety issues. The request is made for the following reasons:

1. As you have pointed out several times, Flakt, Inc., as principal will pay any award which might be rendered against Federal Insurance Company.

2. In our discussions, you have raised no "surety issues" which might be the subject of other proceedings.

3. If the Federal Insurance Company does not

agree to be bound on all issues in the arbitration proceeding, Vemco will file a motion to add the appropriate counts against Federal Insurance Company in the Federal Court proceeding.

Very truly yours,

HILL LEWIS

Jimm F. White

JFW/she
Enclosure

May 30, 1989

Jimm F. White, Esq.
255 S. Woodward Avenue
Suite 205
Birmingham, Michigan 48011

Re: VEMCO, INC. and FLAKT, INC.
(Alpha Division) and
FEDERAL INSURANCE COMPANY;
Case No. 54 133 0152 88

Dear Jimm:

Please be advised that Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety issues and non-surety issues.

Truly,

MAGER, MONAHAN,
DONALDSON & ALBER

Denis C. Monahan

DCM/sah
cc: Mr. Walter J. Maxwell
Ms. Janice Holdinski
Jerry Herrmann, Esq.
Mr. Tom Mark
George D. Mercer, Esq.

APPENDIX H

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

CONCURRENCE IN MOTION FOR CLARIFICATION

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC.,
a Michigan corporation,

Plaintiff,

Civil Action
No. 88CV40331FL

vs.

Judge Stewart
A. Newblatt
(P18257)

FLAKT, INC.,
a Delaware corporation,

Defendant;

and

FLAKT, INC.,
a Delaware corporation,
and FEDERAL INSURANCE COMPANY,
a New Jersey corporation,

Counter-Plaintiffs

v.

VEMCO, INC.,
a Michigan corporation;
JAMES A. SCHUTZ, et al.,

Counter-Defendants.

Timothy D. Wittlinger (P22490)
Jimm F. White (P22256)
Charles G. Goedert (P39645)
Hill Lewis--Attorneys for Vemco, Inc.
and James A. Schutz
32nd Floor, 100 Renaissance Center
Detroit, MI 48243

Denis C. Monahan (P24172)
Raymond C. McVeigh (P33420)
Mager, Monahan, Donaldson & Alber
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Marine Midland Bank, Thomas J. Kelly,
Security Pacific National Trust Company,
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CONCURRENCE OF VEMCO, INC. AND JAMES A. SCHUTZ IN FLAKT'S MOTION FOR CLARIFICATION, OR, IN THE ALTERNATIVE FOR RECONSIDERATION

Plaintiff/Counter-Defendant Vemco, Inc. ("Vemco") and Counter-Defendant James A. Schutz ("Schutz"), by their attorneys, Hill Lewis, concur in the pending Motion for Clarification or in the Alternative, for Reconsideration filed by Defendant/Counter-Plaintiff Flakt, Inc. ("Flakt"), and state as follows:

1. On or about September 29, 1988, Flakt filed a Motion for Order Determining and Staying Arbitrable Claims. Flakt's Motion asserted that arbitration did not apply to any of the claims involving third parties other than Flakt and Vemco.

2. On or about March 23, 1989, the Court entered its Memorandum Opinion and Order ("Order"). The Court found that the arbitration provisions in the Vemco-Flakt Agreement ("Agreement") cover all disputes not exempted from arbitration by Vemco and Flakt which arise from the Agreement because all remaining issues arose out of the same commercial transaction and were intertwined legally and factually.

3. The foreclosure of construction lien claim in Flakt's counterclaim does not arise out of the Vemco-Flakt Agreement.

4. Under both Federal and Michigan law, binding arbitration is only applicable to parties which have agreed in writing to arbitration. See, 9 USC Section 2; MCL 600.5001; MSA 27A.5001. Thus, arbitration is voluntary and must be by agreement of the parties. The various lenders who have not agreed to be bound by the arbitration are not bound by any decision which the arbitrators may issue, and the arbitrators would "exceed their powers" by entering an award relating to such lenders. MCR 3.602.

5. Counter-Plaintiff Federal Insurance Company has agreed to participate in and be bound by the arbitration proceedings as to both surety and non-surety issues in this case.

6. Counter-Defendant James A. Schutz has agreed to be bound by the arbitration proceedings in this case.

7. Counter-Defendant Bituminous Pavers, Inc. has not entered into an agreement to be bound by arbitration of the issues herein.

8. Craig W. Reynolds, in his capacity as individual collateral agent on behalf of The CIT Group/Equipment Financing, Inc. and Marine Midland Bank (Delaware) National Association has not agreed to be bound by arbitration of the issues herein.

9. The CIT Group/Equipment Financing, Inc., in its capacity as corporate collateral agent on behalf of itself and Marine Midland Bank (Delaware) National Association and individually has not agreed to be bound by arbitration of the issues herein.

10. The Marine Midland Bank, a Delaware National Association, a national Banking association has not agreed to be bound by arbitration of the issues herein.

11. Thomas J. Kelly, in his capacity as individual collateral agent on behalf of The New York Life Insurance Company and Aid Association for Lutherans has not agreed to be bound by arbitration of the issues herein.

12. Security Pacific National Trust Company (New York), a national banking association, in its capacity as corporate collateral agent on behalf of The New

York Life Insurance Company and Aid Associations for Lutherans has not agreed to be bound by arbitration of the issues herein.

13. The New York Life Insurance Company, a New York corporation and Aid Association for Lutherans, a fraternal benefit society organized under the laws of the State of Wisconsin has not agreed to be bound by arbitration of the issues herein.

14. Venture Industries Corporation has not agreed to be bound by arbitration of the issues herein.

15. Arbitration proceedings are scheduled to commence on September 11, 1989. Clarification of whether the foreclosure of construction lien claim is arbitrable is essential to the Counter-Defendant lenders in order to prepare their defense.

16. For the reasons stated herein, Vemco and Schutz concur in Flakt's Motion for Clarification or Reconsideration of the Court's Order because the scope of the Court's ruling in its Memorandum Opinion and Order of March 23, 1989 did not address the issue of whether or not the foreclosure of construction lien

claim as it affects the interests of Counter-Defendants Bituminous Pavers, Inc., Craig W. Reynolds, The CIT Group/ Equipment Financing, Inc., Marine Midland Bank, Thomas J. Kelly, Security Pacific National Trust Company, The New York Life Insurance Company, the Aid Association for Lutherans, and Venture Industries Corporation was arbitrable.

WHEREFORE, Vemco and Schutz request that the Court issue a supplemental order clarifying and determining that Flakt's foreclosure of construction lien claim against Counter-Defendants Bituminous Pavers, Inc., Craig W. Reynolds, The CIT Group/Equipment Financing, Inc., Marine Midland Bank, Thomas J. Kelly, Security Pacific National Trust Company, The New York Life Insurance Company, the Aid Association for Lutherans, and Venture Industries Corporation are not arbitrable, and, therefore, cannot be referred to arbitration.

HILL LEWIS

By /s/ Charles G. Goedert
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Dated: June 16, 1989

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC.,
a Michigan corporation,

Plaintiff,

Civil Action
No. 88CV40331FL

vs.

Judge Stewart
A. Newblatt
(P18257)

FLAKT, INC.,
a Delaware corporation,

Defendant;

and

FLAKT, INC.,
a Delaware corporation,
and FEDERAL INSURANCE
COMPANY, a New Jersey
corporation,

Counter-Plaintiffs

v.

VEMCO, INC.,
a Michigan corporation;

JAMES A. SCHUTZ, et al.,

Counter-Defendants.

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PROOF OF SERVICE

STATE OF MICHIGAN)
) SS.
COUNTY OF WAYNE)

Richelle A. Hoffer, being first duly sworn deposes and says that on this 16th day of June, 1989 she served a copy of Concurrence of Vemco, Inc. and James A. Schutz in Flakt's Motion For Clarification, or, in the Alternative For Reconsideration upon:

Denis C. Monahan
Mager, Monahan, Donaldson & Alber
2400 First National Bank Building
Detroit, MI 48226

Gilbert E. Gove
Miller, Canfield, Paddock & Stone
2500 Comerica Building
Detroit, MI 48226

by depositing same in the United States mailbox located in the Renaissance Center in Detroit, Michigan 48243 with postage fully prepaid thereon.

/s/ Rochelle A. Hoffer
Richelle A. Hoffer

Subscribed and sworn to before me
this 16th day of June, 1989.

/s/ Norma Torres
Notary Public,
Wayne County, Michigan
My Commission Expires: 10/15/91

APPENDIX I

STRATEGIC USE OF THE GENERAL INDEMNITY AGREEMENT IN SETTLING BOND CLAIMS OVER A PRINCIPAL'S OBJECTIONS, ABA TIPS, FIDELITY AND SURETY LAW COMMITEE, JANUARY 26, 1996

STRATEGIC USE OF THE GENERAL INDEMNITY AGREEMENT IN SETTLING BOND CLAIMS OVER A PRINCIPAL'S OBJECTIONS

JANUARY 26, 1996
ABA TORT AND INSURANCE PRACTICE SECTION
FIDELITY AND SURETY LAW COMMITTEE

ARMEN SHAHINIAN, ESQ.
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INTRODUCTION.

Centuries of experience have yielded warnings about the perils of suretyship. Most surety counsel have heard the oft-repeated admonition of King Solomon to the citizenry of Israel: "He that is surety for a stranger shall smart for it; and he that hateth suretyship is sure." Proverbs 11:15.[1] In order to reduce the risk associated with suretyship, compensated sureties will generally issue bonds only upon the condition that the named principal and, where the principal is a closely-held corporation, its owners collectively agree to execute a general indemnity agreement (hereinafter "GIA") in favor of the surety. The GIA supplements the surety's common law rights, creating substantial additional rights which the surety will be entitled to

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[1]Similar warnings have been repeated through the years; some of these have been compiled in William H. Woods, Historical Development of Suretyship, From Prehistoric Custom to a Century's Experience With a Compensated Corporate Surety. THE LAW OF SURETYSHIP (ABA, E. Gallagher Ed. 1993).

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*The author gratefully acknowledges the research assistance of Christine Romeo, an associate with Wolf & Samson, in connection with the preparation of this article.

exercise in the event claims are received under its bonds. This paper will discuss the provisions of the GIA which give the surety the flexibility and leverage necessary to mitigate its damages by allowing the surety to resolve claims over the objection of an uncooperative principal without waiving its indemnification rights or exposing itself to liability to the principal for tortious interference with prospective economic advantage or for breach of the surety's implied covenant of good faith and fair dealing.

Performance and payment bond sureties know too well the seemingly, intractable problems that arise when substantial claims are received under their bonds, following which they discover that their principal has neither the economic incentive to compromise such claims nor the financial ability to pay them. Instead, the principal may find itself in such a weakened financial condition that nothing short of a complete victory with respect to contested claims will achieve the economic rescue which it requires. In such circumstances, the principal may have sufficient resources to litigate disputes with both the surety and bond claimants, but not

the economic strength to satisfy judgments which might be entered should it be unsuccessful in prevailing on its counterclaims or defenses.

The principal may, therefore, seek to "roll the dice" in litigation, in effect using the surety's money to do so. Should the surety, facing substantial litigation expense and exposure, seek to enlist the principal's cooperation in achieving reasonable settlements, extortive demands for release of indemnity are often the first words out of the principal's mouth. These demands are sometimes followed by threats of affirmative claims by the principal against the surety if the surety fails, to respond to bond claims as requested.

The surety faces further complications where the principal has brought affirmative claims against an obligee which is claiming under a performance bond or a subcontractor claiming under a payment bond. Reasonable compromise resolutions of the obligee's or subcontractor's claims may only be possible as part of a comprehensive settlement resolving the entire controversy, including the principals affirmative claims. Such a comprehensive settlement may be attrac-

tive to the surety seeking to mitigate damages. It may not be attractive to a failing principal which can quickly come to view the claims resolution process as its last best hope to reverse its sagging fortunes -- if not through successful litigation of its own affirmative claims, then through litigation against its own surety for the surety's perceived interference with such claims. Indeed, the principal may conclude that its ability to impede and undermine the surety's efforts to mitigate damages represents its greatest source of leverage in attempting to escape the economic consequences of its breaches of its bonded obligations.

It is in such a context that the rights afforded sureties under the GIA will be reviewed. No attempt will be made to examine each of the provisions of the typical GIA. An exhaustive review of the cases interpreting its standard clauses is contained in various publications listed in the attached bibliography. Most recently, the Fidelity and Surety Law Committee of the International Association of Defense Counsel prepared a model form of GIA and compiled cases interpreting many of its standard clauses in Project Update 1995: Illustrative

Provisions of a General Indemnity Agreemen Taken in Connection with Contract Surety[2] (hereinafter "IADC's Project Update 1995").[3]

Rather, this paper will focus upon the manner in which courts have interpreted those clauses in the GIA which are typically of greatest import where the principal refuses to cooperate in achieving a reasonable resolution of bond claims and threatens the surety with liability in connection with its efforts to resolve such claims. A summary review of the indemnity, right to settle, and collateral deposit provisions, which have received much attention in the papers referenced in the attached bibliography, will be followed by a more detailed review of the assignment clause, the utility of which has at times been overlooked. The assignment clause, when coupled with the power of attorney clause, may allow the surety to extricate itself

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[2]62 DEFENSE COUNS. J. 259 (1995).

[3]This project was initially undertaken in 1963 and updated in 1975, 1985 and 1995. 42 INS. COUNS. J. 291 (1975), 52 INS. COUNS. J. 118 (1985), and 62 DEFENSE COUNS. J. 259 (1995). Annotations of each of the typical provisions found in most G.A.'s are provided in the updates.

from exposure to substantial bond liability through settlements with claimants seeking complete resolution of both their own claims and the principal's counterclaims, even when the principal attempts to obstruct that result.

THE INDEMNITY CLAUSE: THE SURETY'S RIGHT TO BE WRONG.

A surety which discharges a duty owed by its principal has the equitable right of reimbursement as a matter of common law. This right, however, applies only when the surety satisfies a debt for which its principal is liable.[4] Compensated sureties are not so foolish as to rely upon only this common law right of reimbursement, however. Rather, most GIAs expressly provide for indemnification, the contractual analogue of common law reimbursement, for all losses, costs and expenses incurred by the surety in good faith. As a result of its issuance of bonds on behalf of the principal. The GIA gives the surety a contractual right

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[4]Commercial Ins. Co. of Newark, N.J. v. Pacific-Peru Constr. Corp., 558 F.2d 948, 953 (9th Cir. 1977); Fidelity & Deposit Co. of Maryland v. Bristol Steel & Iron Works, Inc., 722 F.2d 1160, 1163 (4th Cir. 1983).

to indemnification without the need to prove that the principal was in fact liable for the debt incurred. Absent such contractual relaxation of the common law standard for reimbursement, the surety would be unable to resolve claims, short of litigation through judgment, without impairing its indemnity claims.

A typical GIA will contain a clause substantially as follows:

> "In the event of any payment by the Surety, the Contractor and Indemnitors further agree that in any accounting between . . . . them, the Surety shall be entitled to charge for any and all disbursements made by it in good faith . . . under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed; and that the vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the

liability to the Surety."[5]

Such contractual indemnity provisions have been upheld consistently, subject only to the condition that the payment by the surety is not made in bad faith or as the result of its own fraud.[6] Therefore, whether the principal is liable for the obligation satisfied by the surety under its bond is not dispositive of the surety's right to indemnifica-

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[5]This sentence is contained as part of the indemnity clause of the G.A. drafted by a subcommittee of the Claims Advisory Committee of The Surety Association of America in 1965.

[6]Fidelity & Deposit Co. of Maryland v. Bristol Steel & Iron Works, Inc., 722 F.2d 1160, 1163 (4th Cir. 1983); Commercial Ins. Co. of Newark, N.J. v. Pacific-Peru Constr. Co., 558 F.2d 948, 953 (9th Cir. 1977); Transamerica Ins. Co. V. Bloomfield, 401 F.2d 357, 362-363 (6th Cir. 1968); Engbrock v. Federal Ins. Co., 370 F.2d 784, 786 (5th Cir. 1967); Transamerica Premier Ins. Co. v. Nelson, 110 Nev. 951, 878 P.2d 314 (1994); Employers Ins. of Wausau v. Able Green, Inc., 749 F.Supp. 1100 (S.D. Fla. 1990); Fireman's Fund Ins. Co. v. Nizdil, 709 F.Supp. 975, 977 (D.Or. 1989); Ins. Co. of North America v. Bath, 726 F.Supp. 1247, 1251 (D.Wyo. 1989); U.S. Fidelity and Guar. Co. v. Klein Corp., 190 Ill. App.3d., 250, 558 N.E.2d 1047 (Ill.App. 1989); Fidelity & Deposit Co. Of Maryland v. Fleischer, 772 S.W.2d 809 (Mo.App. 1989).

cation.[7] As stated by the court in Transamerica Ins. Co. v. H.V.A.C. Contractors, Inc.:[8] "This agreement did not require (the surety) to be correct in its payment of claims, only to make them in good faith."[9]

Similarly, in Transamerica Premier Ins. Company v. Nelson,[10] the Supreme Court of Nevada, in enforcing a surety's right to indemnification for counsel fees incurred in defending an action even though it was determined that the bond claim was invalid, declared: "When the parties contractually agree that good faith is the standard, undertaking a determination of anything other than good faith is inappropriate."[11]

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[7]Commercial Ins. Co. of Newark, N.J. v. Pacific-Peru Construction Corp., 558 F.2d 948, 953 (9th Cir. 1977); Continent- al Cas. Co. v. Guterman, 708 F.Supp. 953, 954 (N.D. Ill. 1989); Fidelity & Deposit Co. of Maryvland v. Fleischer, 772 S.W.2d 809, 815-16 (Mo.App. 1989).

[8]857 F.Supp. 969 (N.D. Ga. 1994).

[9]Id. at 974.

[10]110 Nev. 951, 878 P.2d 314 (1994).

[11]Id. at 317.

What constitutes good faith, or lack thereof, where sureties seek to enforce their contractual rights of indemnity was addressed by the United States Court of Appeals for the Fifth Circuit in Engbrock v. Federal Ins. Co.[12] There, the indemnitors, seeking to avoid liability under the GIA, claimed that the surety "did not do what it should have done in order to limit or minimize the costs" incurred in completing the bonded project.[13] The Fifth Circuit. in affirming judgment in favor of the surety under the GIA, stated:

> "At most, the pleading alleges negligence by (the) Surety. But neither lack of diligence nor negligence is the equivalent of bad faith; and improper motive, which is not alleged, is an essential element of bad faith. (citations omitted). Hence, we conclude that it was not error for the trial judge to deny admission into evidence of the testimony of (the indemnitors) that the payments

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[12] 370 F.2d 784 (5th Cir. 1967).

[13] Id. 370 F.2d at 7871.

were excessive."[14]

The court in Hartford Accident and Indemnity Co. v. Millis Roofing and Sheet Metal, Inc.,[15] reached a similar conclusion:

> "Want of good faith involves more than bad judgment, negligence or insufficient zeal. It carries an implication of a dishonest purpose, conscious doing of wrong, or breach of duty through motive of self-interest or ill will."[16]

In Safeco Ins. Co. of America v. Criterion Investment Corp.,[17] the court also found that bad faith requires an improper motive and held that although the surety may have improperly paid claims, it was guilty at most of negligence, not bad faith. The court stated: "'Good faith' means honesty in

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[14]Id.

[15]418 N.E.2d 645 (Mass.App.Ct. 1981).

[16]Id. at 647.

[17]732 F.Supp. 834 (E.D. Tenn. 1989).

fact in the conduct or transaction concerned."[18] Applying that standard, the court found that the surety's failure to obtain complete copies of all relevant construction agreements and its payment of claims which might have been defensible in order to avoid litigation, while possibly constituting negligence, did not rise to the level of deliberate malfeasance, which generally is required in order to establish bad faith.

Similarly, as declared by the court in Employers Ins. Co. of Wausau v. Able Green, Inc.,[19] "even gross negligence is not the same as bad faith." In order to establish bad faith, the surety's conduct must "rise to the level of deliberate malfeasance."[20]

While the overwhelming majority of courts defining bad faith sufficient to deny the surety's right to recovery under the GIA have rejected application of a negligence standard, a few aberrations

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[18] Id. at 841.

[19] 749 F.Supp. 1100, 1103 (S.D. Fla. 1990).

[20] Id.

exist.[21] In such cases, it appears that the court misunderstood the nature of the relationship between the indemnitors and the surety.

That relationship is grounded in contract. The parties' obligations are spelled out in the GIA, which imposes no duty upon the surety in favor of the indemnitors to conduct a reasonable investigation of claims under its bonds.[22] Rather, it is the indemnitors who are contractually obligated to exonerate and keep the surety unmolested[23] by such claims. In addition, if the indemnitors believe that there is a proper basis and request denial of bond claims, they are obliged to collateralize the surety.[24]

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[21]See, e.g., City of Portland v. George D. Werd & Associates, Inc., 750 P.2d 171 (Or.App. 1988); Rush Presbyterian St. Lukes Medical Center v. Safeco Ins. Co. of America, 712 F.Supp. 1344 (N.D. Ill. 1989).

[22]Transamerica Ins. Co. v. H.V.A.C. Contractors, Inc., 857 F.Supp. 969, 974 (N.D.Ga. 1994).

[23]Fidelity & Deposit Co. of Maryland v. Bristol Steel & Iron Works, Inc., supra, 722 F.2d at 1165.

[24]See pp. 19-20, infra.

Where the indemnitors breach their obligation to exonerate and collateralize the surety, there is no covenant creating a duty of due care to those indemnitors. Rather, the parties agreed only that the surety would act in good faith with respect to the bond claims which it must then address.

The courts should not disregard the parties, agreement and improperly apply tort theories despite the lack of any contractual duty beyond good faith. Otherwise, indemnitors would be encouraged to breach their contractual obligations, thrust their surety into the claims resolution process from which it was contractually entitled to protection, and then criticize the surety's decisions in resolving claims as unreasonable in an effort to escape liability for their breached contractual commitments. The law in the great majority of jurisdictions does not countenance such a perverse result and requires the surety only to act in good faith, with honesty in fact and without deliberate malfeasance. Provided it does so, most courts will strictly enforce the parties' bargain.

In order to avoid the deliberate malfeasance standard, indemnitors some-

times suggest that the surety is in a fiduciary relationship with them which requires that the surety make their interests paramount. Therefore, they contend that they should be excused from their indemnification obligation upon a showing of mere negligence. These contentions have similarly failed, as courts have declined to characterize the principal/surety relationship as imposing fiduciary obligations upon the surety.[25]

Despite the powerful right to indemnification under the GIA subject only to the good faith standard, a surety obviously should conduct reasonable and proper investigations and exercise due care in determining its liability with respect to bond claims. Notwithstanding provisions of the GIA which provide that no notice to indemnitors regarding the receipt of claims is required, the surety also should provide its principal and the indemnitors with notice of all claims received. It also would be prudent to invite indemnitors to present a written explanation of the basis for any defenses

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[25] Transamerica Ins. Co. v. H.V.A.C. Contractors, Inc., 857 F.Supp. 969, 975 (N.D. Ga. 1994); In Re McNeil, 22 B.R. 408, 413 (Bankr. E.D. Tenn. 1982).

which might exist, together with copies of supporting documents. If that information convinces the surety that it is neither necessary nor expedient under the circumstances to satisfy a claim, the surety will have been provided a basis for denial of the claim, thereby serving the interests of both the surety and its indemnitors. The indemnitors agreed in the GIA, however, that should the surety decide to pay claims or incur expenses, those decisions would not be second-guessed. The surety has the right to be wrong and still obtain indemnification, subject only to the requirement that it act in good faith.

THE RIGHT TO SETTLE CLAUSE.

Most GIA's, either as part of the general indemnity clause or set forth in a separate section, give the surety an express right to settle claims asserted against it. The model "right to settle" provision found in the IADC's Project Update reads as follows:

> "F. Right to Compromise or Settle Claims.
>
> The Company shall have the exclusive right for itself and for the Undersigned to

> decide and determine whether any claim, demand, suit, or judgment shall, on the basis of liability, expediency or otherwise, be paid, settled, defended or appealed, and the Company's determination shall be final, conclusive and binding upon the Undersigned.
>
> If the Undersigned desire that the Company litigate such claim or demand, or defend such suit, or appeal from such judgment, they shall deposit with the Company, at the time of such request, cash or collateral satisfactory to the Company in kind and amount to be used in paying any judgment or judgments rendered, or which might be rendered, against Company together with interest, costs and attorneys' fees."[26]

Such provisions are designed to allow the surety to compromise and resolve claims efficiently and to avoid unnecessary litigation. Right-to-settle provisions are usually coupled with clauses providing that vouchers and other evidence of payment of claims shall be

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[26] IADC'S Project Update 1995, supra at 267.

prima facie evidence of the propriety thereof. Courts have routinely upheld both provisions.[27] The rationale for enforcing these clauses is, in part, that the expense, delay and risk of loss to the surety are sufficient safeguards against unwarranted payments.[28] Courts have generally recognized that these provisions afford the surety broad discretion in determining the claims which should be compromised and settled and have held that the surety's decision will be binding on the principal and indemnitors so long as the surety acts in good faith.[29]

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[27]Transamerica Ins. Co. v. Bloomfield, 401 F.2d 357, 362 (6th Cir. 1968); U.S. Fidelity & Guar. Co. v. Napier Electric 7 Const. Co., Inc., 571 S.W.2d 644, 645 (Ky.App. 1978); National Sur. Corp. v. Peoples Milling Co., 57 F.Supp. 281, 282-283 (W.D.Ky. 1944).

[28]Engbrock v. Federal Ins. Co., 370 F.2d 784, 786 (5th Cir. 1968); Transamerica Ins. Co. v. H.V.A.C. Contractors, Inc., 857 F.Supp. 969, 974 (N.D. Ga. 1994).

[29]As previously noted, most courts addressing the issue have held that, in order to prove lack of good faith under the right to settle clause, the principal or indemnitor must prove that the surety acted with fraud, ill will or some other improper motive, see, e.g., Hess v. American States Ins. Co., 589 S.W.2d 548, 551

The case of Fidelity & Deposit Co. of Maryland v. Fleischer[30] illustrates the value to the surety of the right-to-settle provision of the GIA when the surety faces competing claims of breach by its principal and the obligee. The situation faced by the surety in Fleischer also demonstrates the importance to the surety of making a demand for the deposit of collateral prior to proceeding with settlement of claims under its bond over the objections of its principal.

In Fleischer, the principal entered into a $15 million contract to serve as construction manager in the conversion of a vessel into an entertainment center. Performance and payment bonds were posted in the amount of the contract. During construction, various controversies arose

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(Tex.Civ.App. 1979); Massachusetts Bonding and Ins. Co. v. Gautieri, 69 R.I. 70, 30 A.2d 848, 850 (1943). See also, Ebasco Constructors, Inc. v. A.M.S. Const. Co., Inc., 195 A.D.2d 439, 599 N.Y.S.2d 866 (App. Div., 2d Dept., 1993); Safeco Ins. Co. of America v. Criterion Inv. Corp., 732 F.Supp. 834, 841 (E.D.Tenn. 1989); Hanover Ins. Co. V. Smith., 137 I11.2d 304, 561 N.E.2d 14 (1990); Fidelity and Deposit Co. Of Maryland v. Wu, 150 Vt. 225, 552 A.2d 1196, 1200 (1988).

[30]722 S.W.2d 809 (Mo.App. 1989).

from the failure of the architect/ engineer fully to approve, or the obligee fully to pay, requisitions submitted by the principal. The principal also contended that it was entitled to receive change orders substantially increasing the contract amount. As a result, the principal gave notice of its intention to stop work unless payment of the balance of its requisition was received. The owner, in turn, insisted upon continued performance and advised the principal that payments were not due until they were approved by the architect/engineer and construction lender as specified in the bonded contract. The owner informed the contractor that any work stoppage would be considered a material breach of the contract. Nevertheless, the principal ceased work and did not return to the project.

The obligee proceeded to default the principal and made demand upon the surety to complete under the performance bond. The principal contended that it was not in default because the problems on the job were caused by the owner's agent and because the owner itself failed to perform its contractual obligations. The owner, in turn, contended that the principal breached the contract by

abandoning the work notwithstanding the owner's commitment to make payment as provided in the contract, i.e., subject to the approval of the architect/engineer and only to the extent of such approvals, which it had done. The performance bond provided that there would be no liability on the part of the principal or surety unless the owner made payments to the principal strictly in accordance with the terms of the bonded contract and timely performed all other contractual obligations.

The GIA appears to have been substantially in the form of the GIA prepared by a subcommittee of the Claims Advisory Committee of the Surety Association of America in 1965 which has been used by many sureties over the years. Specifically, the GIA required the indemnitors to make payment to the surety as soon as liability existed or was asserted against the surety whether or not the surety had made any payment therefor; that payment was to be in an amount equal to the amount of the reserves set by the surety; and that the surety would be entitled to be reimbursed for any and all disbursements made by it in good faith "under the belief that it is or was liable for the sums and amounts

so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed . . ." The indemnity agreement also had a right-to-settle provision which gave the surety

> "The right to adjust, settle or compromise any claim, demand, suit or judgment . . . unless the Contractor and the Indemnitors shall request (the surety) to litigate such claim . . . and shall deposit with (the surety) at the time of such request, cash or collateral satisfactory to (the surety) in kind and amount, to be used in paying any judgment or judgments rendered or that may be rendered . . ."

The surety undertook discussions with its principal which, while denying that it had breached the contract, recognized that in order to minimize exposure, it might be appropriate for the surety to take over the contract and retain the principal to complete the project. The surety had also been in communication with the owner. The owner advised that if the surety did not act promptly to complete the ship, the owner

would not do so and that the eventual cost to complete likely would escalate from $4 to $5 million to $20 million or more. While asserting to the owner that the surety had no bond liability because the owner breached the contract, the surety simultaneously advised the contractor that it could not be sure that it would prevail on its position in litigation with the owner; that the owner might be able to prove that it was the principal which had breached the contract; that this possibility exposed both the principal and surety to substantial risk, and that the exposure might be in the area of $30 million if the ship sat there in an incomplete and deteriorating condition.

Negotiations among the principal, surety and owner broke down, following which the surety undertook direct negotiations with the owner and made a collateral deposit demand upon the principal for at least $3 million. The principal took the position that the bonds, and therefore the indemnity agreement, had been voided by the owner's breach of the bonded contract and refused to post the collateral. When its repeated demand for collateral was again refused by the principal, the surety entered into

a takeover agreement with the obligee as a result of which the surety incurred completion costs of $2.6 million. In addition, the surety incurred $2.3 million in payment bond losses. The surety then sought reimbursement from the indemnitors. The indemnitors contested liability for the payment bond losses on the basis of a "pay if paid" clause in the subcontractors' contracts which the indemnitors contended barred the subcontractors' right to payment. The indemnitors contested liability for the surety's performance bond losses upon the contention that it was the owner, not the principal, which was in breach of the bonded contract; that the owner's breach of the bonded contract voided the performance bond; and that the conditions for liability under the bond had not been met. At the trial level, judgment was entered in favor of the indemnitors based upon jury instructions which required a verdict in favor of the indemnitors, inter alia, if: (a) the jury believed the bonds were void and that the subcontractors were only to be paid from funds supplied by the obligee; and (b) they believed that the indemnitors agreed in the GIA to reimburse the surety only if the surety was liable for losses and that the surety was not liable for

losses.

Reversing on appeal, the Missouri Court of Appeals found that, as explicitly provided in the indemnity provisions of the GIA, the surety was entitled to be reimbursed "'for any and all disbursements made by it in good faith . . . under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed.'" In upholding the enforceability of the GIA, the court stated:

> "Such provisions, while strict, are common in indemnity contracts executed by contractors and others to induce the execution of bonds by compensated sureties. (citations omitted) They have been uniformly sustained and upheld. The only exception arises when the payment has been made through fraud or lack of good faith on the party of the surety. (citation omitted)
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> * * *

Under the Agreement of Indemnity, the burden was not placed on (the surety) to determine whether owner or contractor first breached the contract. Rather, once owner or the subcontractors made demand on (the surety) under the bonds, (the surety) could make good faith disbursements if it believed it was liable, or if it believed disbursement was necessary or expedient, 'whether or not such liability, necessity or expediency existed.'

The Agreement of Indemnity did not leave (the indemnitors) without a means to prevent such payments. Paragraph Thirteenth provided that (the surety's) right to settle claims could be terminated if (the indemnitors) (1) requested (the surety) to litigate the claims and (2) at the time of the request, deposited collateral with (the surety) to satisfy any judgments and expenses. Nothing in the record suggests that (the indemnitors) requested (the surety) to litigate the claims. Further, (the indemnitors) admit that they did not deposit any collateral even after (the surety) requested that

they do so.

> Thus, (the indemnitors) opted not to take advantage of these provisions of Paragraph Thirteenth. As a result, under the provisions of Paragraphs Second (the indemnity clause) and Thirteenth, (the surety) had the right to settle any claim in good faith whether or not liability, necessity or expediency existed."[31]

Thus, as recognized by the Fleisher court, the surety is not obligated to be correct in forecasting the accuracy of the principal's assertions that it is not in breach of its obligations and that, therefore, the surety, should disclaim liability. While it is certainly advisable that the surety conduct an investigation of the merits of the principal's position so that it might make an informed judgment when assessing its responsibilities under the bond, the surety is not obligated to gamble on the outcome of any resulting litigation with the obligee so long as it acts in good faith. The GIA contemplates that if the principal truly desires that such a

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[31] Id. at 815-816.

gamble be made, the indemnitors secure the surety against the loss which may flow from an adverse judgment; that is, that the indemnitors, not the surety, take the risk and put their money on the table. Failing to do so, the indemnitors cannot complain about the manner in which the surety exercises its judgment in determining how best to mitigate its loss.

THE COLLATERAL DEPOSIT CLAUSE.

Typically, The GIA will also contain a collateral deposit clause requiring the deposit of collateral by their indemnitors with the surety as soon as liability is asserted against the surety. An excellent collateral deposit clause is contained in the IADC's Project Update 1995 of the Annotated Model General indemnity Agreement. An excerpt from that clause follows:

> "The Undersigned will deposit with the Company as collateral security, immediately upon demand, a sum of money, at the option of the Company, equal to (1) the liability of the Company, if established; (2) the liability asserted against the Company; or (3) the reserve established by the Company,

> or any increase thereof, to cover any liability, loss, expense or possible liability for any loss or expense for which the Undersigned may be obligated to indemnify the Company under the terms of this Agreement"[32]

In enforcing the collateral deposit provision, the surety need not establish that the principal is in fact liable for the claim asserted. Rather, it is sufficient that there is a claim or demand upon the surety to perform under the bond.[33] The very purpose of the collateral deposit provision is to place the surety in funds while the issue of the underlying liability of the principal is being adjudicated. Therefore, as recognized by the Ninth Circuit in Safeco Ins. Co. of America v Schwab,[34] the collateral deposit provision would be rendered meaningless unless the surety's right to receive funds arose as soon as a claim under the bond had been made; for once liability

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[32]IADC'S Project Update 1995, supra at 260.

[33]Safeco Ins. Co. of America v. Schwab, 739 F.2d 431, 434 (9th Cir. 1984).

[34]739 F.2d 431, 433 (9th Cir. 1984)

was established, the surety would have the right to exoneration and indemnification and would have no need for the deposit of collateral.[35]

As stated by the court in Standard Sur. and Cas. Co. v. Caravel Industries Corp.[36] in enforcing a collateral deposit provision in favor of a surety pursuant to a GIA: "Defendants did not agree to post collateral only if a valid claim were made, but if any claim were made and (the surety) found it necessary in consequence thereof to set up a reserve."[37]

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[35]See also Milwaukee Const. Co., Inc. v. Glens Falls Ins. Co., 367 F.2d 964 (9th Cir. 1966); National Sur. Corp. v. Titan Const. Co., 26 N.Y.S.2d 227. aff'd, 24 N.Y.S.2d 141 (App.Div., 1st Dept., 1940); Standard Surety and Casualty Co. v. Caravel Industries Corp., 15 A.2d 258 (N.J. Ch. 1940); United Bonding Ins. Co. v. Stein, 273 F.Supp. 929 (E.D. Pa. 1967).

[36]15 A.2d 258 (N.J. Ch. 1940).

[37]Id. at 260-61 . For a more in-depth review of the surety's right to enforcement of the collateral deposit provisions, see Meeker, Surety's Right to Specific Performance of the Indemnity Agreement, No. 2 THE CONSTRUCTION LAWYER 3, Spring 1982. See also Annotations in IADC's Project Update 1995 at 262. The standards for obtaining preliminary injunctive relief in enforcing the surety's rights are also addressed in J.M. Mann, Exoneration and Quia Timet Remedies

THE SURETY'S RIGHT TO EMPLOY INDEPENDENT COUNSEL AT THE PRINCIPAL'S EXPENSE AND OVER THE PRINCIPAL'S OBJECTION.

When a principal contests the validity of claims asserted against its surety's bonds, the principal will frequently offer to defend the surety. Indeed, the principal often will demand that the surety rely solely upon the principal's own counsel and will advise the surety that, should the surety refuse to do so, the principal and indemnitors shall deem themselves excused from any obligation to pay for the counsel fees and costs incurred by the surety's separate counsel. While there are circumstances under which the surety may accept the principal's offer to engage counsel to defend both the principal and the surety jointly, in many circumstances the principal's and surety's interests diverge and retention of separate counsel by the surety is both necessary and appropriate.

When the surety is not convinced that the principal has bona fide defenses

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of the Surety, Ch. 28, THE LAW OF SURETYSHIP (ABA, E. Gallagher, Ed. 1993).

and will not adequately and properly discharge its and the surety's obligations under the bonds, the surety should promptly demand compliance by the principal with its obligations under the GIA including its obligation to post collateral sufficient to cover the surety's exposure. The principal's compliance with the collateral deposit demand will, in the overwhelming majority of cases, evidence the existence of a bona fide dispute between the principal and the claimant rather than an attempt by the principal to postpone the payment of a proper obligation. Under those circumstances and provided that the surety has satisfied itself as to the bona fides of the principal's defenses, the surety may feel confident in accepting the principal's offer of a joint defense by the principal's counsel at the principal's expense.

The principal's failure to collateralize the surety, however, constitutes a default under the GIA, entitling the surety to immediate enforcement of its rights against the principal and indemnitors and to the representation of its own counsel for that purpose. Obviously, counsel for the principal cannot possibly undertake the representation of the sure-

ty in enforcing the surety's rights against counsel's other client, the principal. Rules governing attorney ethics in any jurisdiction should preclude the principal's counsel from undertaking such joint representation.[38] Thus, the demand for enforcement of the surety's collateral deposit rights serves to reveal clearly the divergent interests of the principal and surety which requires the surety's separate representation.[39] Under the circumstances, the principal will be unable to fulfill even its purported offer that the surety rely upon the

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[38]See generally Cunningham, Jr., F.M. The Ethical Considerations of Representing a Principal and a Surety, BOND DEFAULT MANUAL, 2d ed. (ABA, D. Clore ed., 1995); Albritten, M.K., Langfitt, C.W., Legal and Practical Problems with Joint Representation of the Principal and Surety, ABA TIPS Fidelity & Surety Law Committee, August 13, 1991.

[39]In Central Towers Apartments, Inc. v. Martin, 453 S.W.2d 789 (Tenn.Ct.App. 1969), the court, in denying a surety's claim for counsel fees under a GIA, set forth a series of factors to be considered in determining the surety's entitlement to counsel fees. The court distinguished the case of Transamerican Ins. Co. v. Bloomfield, 401 F.2d 357 (6th Cir. 1968), which also applied Tennessee law in awarding the surety counsel fees under the GIA on the basis, inter alia, that in Transamerican the surety's collateral deposit demand had been ignored.

principal's own counsel, as such counsel could not undertake such joint representation in light of the patent conflict.[40]

The surety's entitlement to the recovery of counsel fees under these circumstances is illustrated in the United States Court of Appeals for the Tenth Circuit's decision in United Riggors and Erectors, Inc. V. Marathon Steel Co.[41] The indemnitors had successfully argued in the trial court that, because they had offered to defend the surety against a performance bond obligee's claim and had succeeded at trial in defeating that claim, the surety should not be reimbursed for the fees incurred by it in retaining separate counsel. Reversing, the Tenth Circuit noted that

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[40]At times the courts have ignored technical conflicts where the surety asserted crossclaims under the GIA but the indemnitors were not actively disputing their indemnity obligation. Commercial Standard Insurance Co. V. Cleveland, 345 P.2d 210 (Ariz. 1959); Central Towers Apartments, Inc. V. Martin, 453 S.W.2d 789 (Tenn.-Ct.App. 1969). However, when a collateral deposit demand has been made and refused by the indemnitors, no passive indemnity demand is involved and the ethical conflict would be patent, substantial, and immediate.

[41]725 F.2d 87 (10th Cir. 1984).

the indemnitors had been unable to post the collateral requested by the surety as required under the indemnity agreement and that, accordingly, the surety had reason to doubt the principal's ability to satisfy an adverse judgment and even perhaps its ability to remain. solvent during the pendency of the litigation.[42] The court found that, under these circumstances alone, the surety was justified in retaining separate counsel at the indemnitors' expense in accordance with the express terms of the GIA.[43]

Even when collateral has been posted, if the surety is not comfortable with the joint representation of its interests by the principal's counsel -- whether because of continuing concerns as to the validity of the principal's defenses, the existence of separate surety defenses or otherwise -- the express language of most GIAs would allow the surety to be indemnified for the counsel fees it incurs in defending itself, as such costs will have been incurred by reason of the surety's having executed bonds on the principal's

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[42] Id. at 90.

[43] Id.

behalf.[44]

The surety's entitlement to the recovery of counsel fees and costs is not limited to those incurred in defending bond claims and in enforcing the terms of the GIA. Under the language of most GIA's, the surety may also recover all counsel fees and costs incurred as a result of having executed bonds. Recovery of counsel fees, therefore, may extend to those incurred in defending affirmative claims brought by the principal against its surety which arise out of the surety's execution of bonds on the principal's behalf.

In TPK Const. Corp. V. Southern American Ins. Co.[45] the surety executed bid bonds on behalf of its principal on two public projects in New York even though the surety was not licensed to issue such bonds in New York. The prin-

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[44]A detailed review of the surety's entitlement to recovery of counsel fees under the GIA is beyond the scope of this paper. See generally, Dodge, D., A Surety's Right to Indemnification From the Principal for Attorneys' Fees Incurred in Defense of suit Brought on its Bond, 16 THE FORUM 556 (1980).

[45]752 F.Supp. 105 (S.D.N.Y. 1990).

cipal's low bid was rejected as a result, following which it sued the surety for negligence and breach of contract seeking recovery of its lost profits. The surety counterclaimed against the principal and instituted a third-party action against the indemnators to recover the counsel fees incurred in defending the action. The court dismissed the principal's negligence count against the surety in light of the language of the GIA establishing that the good faith standard is governs the relationship between the principal and the surety.[46] The court further held that the surety was entitled to recover against the indemnitors on the surety's counterclaim for its counsel fees incurred in defending against the principal's claims unless the principal showed that the surety had breached its covenant of good faith and fair dealing.[47] Thus, if the surety's issuance of the bonds was the product of its negligence, rather than its intentional misfeasance, all losses and expenses arising as a result of the surety's execution of the bonds would be subject to the principal's indemnification obligation including the

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[46] Id. at 111-112.

[47] Id. at 112.

surety's execution of the bonds would be subject to the principal's indemnification obligation including the surety's right to recover the counsel fees incurred in defending itself against the principal's claims.

THE SURETY'S ASSIGNMENT RIGHT.

A standard clause of the GIA which is underutilized by sureties, but is of substantial import when dealing with an intransigent principal, is the assignment clause. The typical assignment clause is triggered by an event cf default by the principal including, among others, breach of any bonded contract, failure to pay obligations when due and failure to comply with the principal's indemnity obligation. Upon the occurrence of such an event, the surety is granted a collateral assignment of all rights of the principal arising out of all bonded contracts and all subcontracts let in connection with any bonded contracts. The language of most GIAs makes the assignment effective as of the date of the bond covering the contract, subject to the condition subsequent of an event of default.

An example of such an assignment

clause is found in the GIA drafted in 1965 by a subcommittee of the Claims Advisory Committee of the Surety Association of America, which provides:

> THIRD: The Contractor, the Indemnitors hereby consenting, will assign, transfer and set over, and does hereby assign, transfer and set over to the Surety, as collateral, to secure the obligations in any and all of the paragraphs of this Agreement and any other indebtedness and liabilities of the Contractor to the Surety, whether heretofore or hereafter incurred, the assignment in the case of each contract to become effective as of the date of the bond covering such contract, but only in the event of (1) any abandonment, forfeiture or breach of any contracts referred to in the Bonds or of any breach of any said Bonds; or (2) of any breach of the provisions of any of the paragraphs of this Agreement; or (3) of a default in discharging such other indebtedness or liabilities when due; or (4) of any assignment by the Contractor for the benefit of creditors, or of the

appointment, or of any application for the appointment, of a receiver or trustee for the Contractor whether insolvent or not; or (5) of any proceeding which deprives the Contractor of the use of any of machinery, equipment, plant, tools or material referred to in section (b) of this paragraph; or (6) of the Contractor's dying, absconding, disappearing, incompetency, being convicted of a felony, or imprisoned if the Contractor be an individual: (a) All the rights of the Contractor in, and growing in any manner out of, all contracts referred to in the Bonds, or in, or growing in any manner out of the Bonds; (b) All the rights, title and interest of the Contractor in and to all machinery, equipment, plant, tools and materials which are now, or may hereafter be, about or upon the site or sites of any and all of the contractual work referred to in the Bonds or elsewhere, including materials purchased for or chargeable to any and all contracts referred to in the Bonds, materials which may be in process of construction, in storage elsewhere,

or in transportation to any and all of said sites; (c) All the rights, title and interest of the contractor in and to all subcontracts let or to be let in connection with any and all contracts referred to in the Bonds, and in and to all surety bonds supporting such subcontracts; (d) All actions, causes of actions, claims and demands whatsoever which the Contractor may have or acquire against any subcontractor, laborer or materialman, or any person furnishing or agreeing to furnish or supply labor, material, supplies, machinnery, tools or other equipment in connection with or on account of any and all contracts referred to in the Bonds; and against any surety or sureties of any subcontractor, laborer, or materialman; (e) Any and all percentages retained and any and all sums that may be due or hereafter become due on account of any and all contracts referred to in the Bonds and all other contracts whether bonded or not in which the Contractor has an interest.

The surety's assignment rights may

not be effective as against third parties, such as a financing bank which has perfected its security interest, in the absence of a prior filing by the surety of a Uniform Commercial Code financing statement. The GIA's assignment provisions, however, are effective as against the principal whether or not the GIA has been filed as a financing statement.[48]

One of the first cases demonstrating the value to the surety of the GIA's assignment-of-claims provision was Compania De Remorque v. Salvamento S.A. v. Esperance, Inc.[49] In Esperance, an action was commenced by an obligee under a performance bond seeking recovery from both the surety and principal with respect to a bonded towing contract. The principal, alleging the obligee's breach of the bonded contract, counterclaimed. Thereafter, a settlement was reached between the obligee and surety pursuant to which payment in a reduced amount was

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[48] Western Cas. & Sur. Co. v. United States, 124 Ct.Cl. 156, 109 F.Supp. 422 (Ct.Cl. 1953); Petrossi Bros. Contracting Corp. v. Town of Greece, 29 N.Y.S.2d 305 (Sup.Ct. 1941).

[49] F.2d 114 (2d Cir. 1951).

to be made by the surety to the obligee in exchange for a release. The principal objected to the surety's settlement with the obligee and demanded that the surety release its contractual right of indemnification as a condition to the principal's assent to the settlement with the obligee. The surety refused, proceeded with the settlement over the principal's objection, and thereafter sought indemnification.

Under the GIA, the principal had assigned to the surety all of its assets and property, including all claims it might have. The principal further gave the surety the right to prosecute such claims and "receive any monies in connection therewith, either by settlement, judgment or otherwise, to apply said monies to indemnify it against losses" on the bond. The GIA also provided that the surety would "'have the exclusive right for itself, and for the principal on said bond to decide whether to settle any claim against either.'"[50] After the settlement was concluded by the obligee with the surety, the obligee successfully moved for summary judgment dismissing the

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[50]F.2d at 116.

principal's counterclaim on the ground that, because of the principal's assignment of claims to the surety, the principal was no longer the real party in interest. The principal then filed suit against the surety to recover for the obligee's breach of contract on the ground that the surety settled the principal's claims without its consent. The United States Court of Appeals for the Second Circuit held that the GIA gave the surety the right to settle the principal's claims against the obligee and therefore dismissed the principal's claims against the surety. It concluded that the surety had the right to settle and did so in good faith.[51]

These fundamental rights of the surety created by the GIA continue to be vindicated. In James McKinney & Son, Inc. v. Lake Placid 1980 Olympic Games, Inc.[52] an action was commenced by a principal against an obligee and its construction manager based upon the obligee's alleged breaches of its contract with the principal. Prior to the institution of that action, however, the obligee had declared

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[51] Id. at 117.

[52] 462 N.E.2d 137 (N.Y. 1984).

the principal in default in its performance of the contract and had made demand upon the principal's surety to complete performance. The surety had undertaken performance but had, itself, encountered difficulties in prosecuting the work, whereupon it entered into a settlement agreement with the obligee. Pursuant to the terms of the settlement, the surety released the obligee from all claims it had, by assignment or otherwise, arising out of the bonded contract.

Under the circumstances, the New York Court of Appeals dismissed the principal's action against the obligee, finding that, under the terms of the GIA, the principal had assigned to the surety all rights which the principal had "in or growing in any manner out of" the bonded contract. Consequently, the principal was no longer the real party in interest with respect to the claims it was asserting against the obligee. Those claims, having been assigned to the surety, were properly held to have been released in its settlement with the obligee.

The particular utility of the assignment provisions of the GIA when the

surety is faced with an obstructionist principal is illustrated in the recent case of Hutton Constr. Co. Inc. v. County of Rockland.[53] The underlying factual scenario presented in Hutton is all too familiar to surety companies. Hutton entered into a contract which the County of Rockland for the installation of a storm sewer system for the County. Three bonding companies, act- ing as co-sureties, executed a perform- ance and payment bond on Hutton's behalf to secure Hutton's performance of the contract. Hutton contended that it encountered unanticipated rock and water conditions on the site which were not revealed on the plans and specifications and which required the performance of substantially more work. Hutton asserted that it was entitled to change orders significantly increasing the contract price. When the County refused to issue the change orders and make increased payments, Hutton ceased work, was terminated, and commenced an action against the County seeking damages for both its increased costs and the County's wrongful termination of its contract. The County counterclaimed for Hutton's failure to

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[53] 1993 W.L. 53012 (S.D.N.Y. 1993), aff'd, 52 F.2d 1191 (2d Cir. 1995).

complete its work and asserted claims against the sureties for their refusal, following the County's default termination of Hutton, to complete the project. (The sureties previously had denied liability based upon Hutton's contentions regarding the County's breach of contract.) The County also impleaded its design engineer which was defended by its insurer.

Litigation proceeded, with the result, as noted by the trial court that the "fruits of some five years of discovery provided substantial conflicting evidence on virtually every issue."[54] The principal not only lacked sufficient resources with which to satisfy an adverse judgment, but it could not even finance its litigation costs. Therefore, the sureties had been called upon to finance the cost of both counsel and expert witnesses for themselves and for the principal. In addition, the sureties had satisfied various payment bond claims. As a result, by the eve of trial, the sureties had spent $1.3 million on payment bond claims and litigation expenses. Pursuant to the collateral

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[54]1993 W.L. 535012, 4.

deposit provisions of the GIA, the sureties requested that the principal collateralize them against any risk of an adverse judgment. The principal, in breach of the GIA, failed both to reimburse the sureties for amounts already incurred and to collateralize the sureties against the risk of an adverse judgment on the obligee's counterclaim.

By the trial court's account, the sureties faced three potential outcomes from the litigation process. First, Hutton could prevail on its claims and recover a judgment sufficient to reimburse the sureties for the $1.3 million expended by them and for the further costs and expenses of a projected five-week trial. Second, Hutton might recover a lesser amount and, in light of Hutton's admitted inability to pay any sums from its own resources, the sureties would not be fully indemnified. Third, a substantial adverse verdict might be awarded against the sureties and in favor of the County with no prospect of indemnification of the sureties by the indemnitors under the GIA.

Therefore, the sureties attempted to negotiate a settlement with the consent of their principal so as to avoid

the substantial risks posed by the impending trial. Unfortunately, the principal would not settle. It demanded not only that any settlement include a waiver by the sureties of their indemnification claims for the $1.3 million already incurred, but also that the sureties themselves contribute $1 million to a settlement fund so that the principal would realize a net recovery of nearly $2 million. As recognized by the trial court,

> "Having thus resisted settlement, Hutton approached the trial with only upside potential: If it recovered, it might keep some portion of the recovery; if it lost, it would ignore the verdict and the Sureties. . . . Thus, Hutton proposed to play this high stakes game with the proverbial O.P.M. (other people's money) in this case, the Sureties'. In contrast, the Sureties approached the trial with justifiable concern for an adverse verdict and little hope of recovering from Hutton any of their substantial outlays. Settlement was the only course which would allow the Sureties to guard against a large jury

> verdict while ensuring at least some reimbursement for the funds expended. . . ."[55]

The GIA in use in the Hutton case was the form drafted by the subcommittee of the Claims Advisory Committee of the Surety Association of America in 1965. Its assignment provisions granted to the sureties assignments effective in the event of

> "(1) any abandonment, forfeit or breach of any contracts referred to in the Bonds . . . or (2) of any breach of the provisions of any of the paragraphs of this Agreement . . . [assigning] (a) all the rights of [Hutton] in and growing in any manner out of, all contracts referred to in the Bonds . . . (e) Any and all percentages retained and any and all sums that may be due or hereafter become due on account of any and all contracts referred to in the Bonds . . ."[56]

Having failed to obtain the prin-

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[55] Id., 1993 W.L. 535010, 4-5.

[56] Id., 1993 W.L. 535012, 2.

cipal's consent to any reasonable settlement and faced with the substantial risk of a large verdict against them for which the principal would be unable to provide indemnity, the sureties proceeded to negotiate a settlement with the obligee and the liability carrier for the obligee's engineer. The settlement called for all claims asserted against the sureties by the obligee to be dismissed and for the payment to the sureties, as assignee of Hutton of $675,000 in full satisfaction of Hutton's claims against the obligee and its engineer. In exchange, the sureties would release the County and its engineer not only from those claims which the sureties might have against them directly, but also, from all claims which the sureties' principal, Hutton, might have against them. The sureties relied upon the GIA's assignment provision together with its power of attorney clause, which provided in pertinent part that:

> "The Contractor and Indemnitors [Hutton] hereby irrevocably nominate, constitute, appoint and designate the Surety as their attorney-in-fact with the right, but not the obligation, to exercise all of the rights

> of the Contractor and Indemnitors assigned . . . to the Surety in this Agreement. . . ."[57]

Although contractually entitled, the sureties could not obtain and deliver a stipulation of dismissal with prejudice from counsel of record for their principal. For that reason and because the principal contested the sureties' right to settle the principal's affirmative claims, the sureties moved before the trial court for an order enforcing the settlement agreement and confirming the sureties, right to dismiss, with prejudice, their principal's claims over its objections.

The trial court granted the sureties, motion, noting its right to enforce settlement agreements under its equitable powers where "'parties are unwilling to drop litigation unless a court invokes its equitable powers to enforce their agreement [citation omitted].'"[58] In so ruling, the court held that the attorney-in-fact and assignment clauses of the GIA "unambiguously" gave the sure-

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[57] Id., 1993 W.L. 535012, 2.

[58] Id., 1993 W.L. 535012, 3.

ties the right to settle the principal's affirmative claims arising from the bonded contract. As stated by the court,

> "Those clauses authorize the Sureties to exercise all of Hutton's rights arising from the Contract and entitle the Sureties to any sums due to Hutton under the Contract. Here, the Sureties elected to exercise these rights by settling both the County's claim against Hutton and Hutton's claim against the County, and the Court finds that they were authorized to do so."[55]

On appeal, the United States Court of Appeals for the Second Circuit affirmed the district court's ruling, stating,

> "The Agreement of Indemnity unambiguously provides that all of Hutton's rights 'growing in any manner out of' the ensured contracts were assigned to the Sureties when Hutton breached the Agreement by failing to indemnify the Sureties on

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[55] Id., 1993 W.L. 535012, 7.

> demand. The Assignment Clause and the Attorney-in-Fact Clause give the Sureties the authority to settle all claims on behalf of Hutton, including not only claims against the Sureties 'upon the bonds,' but also Hutton's affirmative claims growing out of its insured contracts."[60]

The Hutton decision illustrates once again the importance of clearly and unequivocally establishing that the principal is, in fact, in default under the terms of the GIA in order to trigger the surety's assignment rights. Moreover, the indemnitors' failure to comply with their indemnification obligations helps focus the attention of the court upon the predicament in which the surety typically finds itself. Specifically, while indemnitors often stridently assert that they are not in default under the bonded contract and that the surety should not settle or resolve claims, they quite frequently fail to comply with their indemnification obligations and instead seek to avoid the plain bargain struck by them when they initially induced the surety to undertake the risk associated

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[60] Id., 52 F.3d 1192.

with the issuance of its bonds. Courts, quite properly, have not allowed indemnitors to escape their clear and unambiguous undertakings in the GIA while "rolling the dice" with the sureties' money.

ASSIGNMENT RIGHTS ON FEDERAL PROJECTS

On federal projects, the Assignment of Claims Act,[61]; may interfere with the surety's ability to release the United States from any liability which it may have for claims of the bonded principal. The Assignment of Claims Act prohibits a government contractor from assigning its interest in its contract to any person or entity other than a bank, trust company or other financing institution for purposes of asserting a claim against the United States. Because a surety is not a bank, trust company or financing institution, the provision of the GIA which assigns to the surety the principal's claims arising under its bonded contracts with the government has been held to be null and void as against the United States. United States v.

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[61]41 U.S.C. §15.

Munsey Trust Co.;[62] Royal Indemnity Co. v. United States;[63] London and Lancashire Indem. Co. of America v. Endres.[64] It also has been held, however, that the Act protects only the government and cannot be asserted as between the assignor and assignee. In Re Freeman;[65] Danning v. Mintz;[66] United States v. Certain Space in Property Known as Chimes Bldg., Syracuse, N.Y..[67]

Accordingly, it could be argued that while the surety may be precluded from asserting the principal's claims against the United States, it is nevertheless authorized to provide a release to the government of the principal's claims arising under a bonded contract.

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[62]332 U.S. 234, 237 n.7 (1946).

[63]93 F.Supp. 891, 894 (Ct.Cl. 1950).

[64]290 F. 98, 101 (8th Cir. 1923).

[65]489 F.2d 431, 432-433 (9th Cir. 1973).

[66]367 F.2d 304, 306-307 (9th Cir. 1966), cert. denied, 386 U.S. 990. 87 S.Ct. 1305, 18 L.Ed.2d 335 (1967).

[67]320 F.Supp. 491, 496 (N.D.N.Y. 1969), aff'd on opinion below, 435 F.2d 872 (2d Cir. 1970), cert. denied, 402 U.S. 908 (1971).

There is no direct precedent on this point. However, those cases which have held that the anti-assignment provisions of the Assignment of Claims Act may not be asserted as between the assignor and assignee may assist a surety seeking to resolve claims on a federal project over the objection of its principal.

PRESERVING THE PRINCIPAL'S CLAIMS.

Sometimes, a surety need not compromise a principal's affirmative claims in order to achieve resolution of a bond claim. In some circumstances, the surety may be able specifically to preserve any rights which the principal might have. Moreover, the surety also may be in a position to require the obligee to agree to disgorge any monies which the surety pays to the obligee, with interest, if it is subsequently determined in litigation between the principal and the obligee that the principal was not, in fact, in default of the bonded contract. Certainly, where the surety is entering into a settlement in which it is paying the full amount claimed by the obligee, the obligee should have no good reason to refuse to refund such payment should a

court subsequently determine that the obligee's claim was unfounded because the principal was not in breach of the bonded contract.

The benefit to the surety of preserving the principal's claims is well illustrated by the case of Fidelity & Deposit Co. of Maryland v. Bristol Steel and Iron Works, Inc.[68] In Bristol Steel, the principal entered into a contract for bridge construction with the Pennsylvania Department of Transportation ("PennDOT"). After the contractor asserted that it had completed the bonded contract, PennDOT discovered certain alleged defects in its work. It thereupon asserted a substantial claim against the contractor for default, and the contractor responded by denying liability and refusing to make the repairs demanded at its own expense. PennDOT made demand upon the sureties, which also denied liability, on the basis of their principal's denial of default. PennDOT then proceeded to declare the sureties in default of their bond obligations and to disqualify them from acting as surety on any future PennDOT contracts. That

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[68] 772 F.2d 1160 (4th Cir. 1983).

disqualification adversely affected the sureties' business relations with other principals and their ability to participate in the Pennsylvania public transportation contracting market.

The sureties undertook to negotiate with PennDOT, while keeping the principal informed of the negotiations as they proceeded. Ultimately, PennDOT and the sureties agreed that if the pending arbitration between the principal and PennDOT resulted in a determination that the principal had not breached the bonded contract, then PennDOT would refund, with interest, the payment made by the sureties in settlement of PennDOT's claim. Moreover, the settlement agreement provided:

> "'This Agreement is not intended, and shall not be used, to infringe upon or in any way affect the position or rights of Bristol (the Contractor) to pursue its rights under and with reference to the Contract.'"[69]

When the sureties brought an action to recover their payments to PennDOT, the

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[69] Id. At 1164.

principal sought to avoid its indemnity obligation. Rejecting that effort, the court found that the sureties acted with the utmost good faith in entering into the settlement. The sureties had openly disclosed to the contractor that they entered into the agreement because they wished to resume writing surety bonds in connection with road work in Pennsylvania. The court found that this "was a perfectly reasonable consideration on the part of the Sureties."[70] The court also noted that the principal had not suggested that it had any objection to the sureties' settlement.

The court declared that the principal was "'bound not simply to indemnify the surety but to keep it unmolested, and this before the surety has paid the principal's debt.'"[71] The court further noted that after indemnifying the sureties in full, should the principal prevail in its pending arbitration with PennDOT, it would be subrogated to the sureties' rights under their settlement agreement with PennDOT to recover the settlement payment plus interest.

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[70] Id.

[71] Id. At 1165.

CONCLUSION.

The GIA provides the surety with powerful rights not available to it at common law. Careful use of those rights, coupled with a reasonable investigation of claims, should protect the surety against the unreasonable demands of an obstructionist and impecunious principal and enable the surety to recover a judgment for the full amount of its losses and expenses. Absent the protection afforded by the GIA, sureties long ago would have learned the lesson found inscribed on a tablet in the Delphian Temple attributed to the Greek sage and philosopher Thales: "Suretyship is the precursor of ruin."[72]

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[72]William H. Woods, Historical Development of Suretyship. From Prehistoric Custom to a Century's Experience With a Compensated Corporate Surety. THE LAW OF SURETYSHIP (ABA, E. Gallagher, Ed. 1993), quoting from C.W. Crist, Jr., CORPORATE SURETYSHIP (1st Ed. 1939).

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APPENDIX J

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

MOTION FOR CONFIRMATION OF THE ARBITRATION AWARD AND FOR FINAL JUDGMENT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC., a Michigan corporation,

Plaintiff,

v.

FLAKT, INC., a Delaware corporation,

Defendant.

Civil Action No. 88CV40331FL
JUDGE STEWART
A. NEWBLATT

Consolidated With Civil Action No. 88CV40365FL

JUDGE STEWART
A. NEWBLATT

VEMCO, INC., a Michigan corporation; JAMES A. SCHUTZ; BITUMINOUS PAVERS, INC., a Michigan corporation; CRAIG W. REYNOLDS, in his capacity as individual collateral-agent on behalf of The CIT Group/ Equipment Financ-

VEMCO'S MOTION FOR CONFIRMATION AWARD AND FOR FINAL JUDGMENT ON ARBITRATION AWARD

ing, Inc. and Marine Midland Bank (Delaware) National Association; THE CIT GROUP/EQUIPMENT FINANCING, INC., in its capacity as corporate collateral agent on behalf of itself and Marine Midland Bank (Delaware) National Association and individually; MARINE MIDLAND BANK, a Delaware National Association, a national banking association; THOMAS J. KELLY, in his capacity as individual collateral agent on behalf of The New York Life Insurance Company and Aid Association For Lutherans; SECURITY PACIFIC NATIONAL TRUST COMPANY (New York), a national banking association, in its capacity as corporate collateral agent on behalf of The New York Life Insurance Company and Aid Associations For

Lutherans; THE NEW YORK LIFE INSURANCE COMPANY, a New York corporation; and AID ASSOCIATION FOR LUTHERANS, a fraternal benefit society organized under the laws of the State of Wisconsin; VENTURE INDUSTRIES CORPORATION, a Michigan corporation,

Counter-Defendants.

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VEMCO'S MOTION FOR CONFIRMATION OF ARBITRATION AWARE AND FOR FINAL JUDGMENT ON ARBITRATION AWARD

Vemco, Inc. ("VEMCO"), by and through its attorneys, Keywell and Rosenfeld, moves for confirmation of the Arbitration Award dated June 15, 1993 and entered on July 8, 1993 against Flakt, Inc. ("FLAKT") and Federal Insurance Company ("FEDERAL") and for entry of a final judgment pursuant to F. R. Civ. P. 54(b) and 81(a) as follows:

1. In November, 1987,[1] VEMCO and FLAKT entered into a contract for the design, fabrication, installation, start-up, testing and completion of a paint finishing system in Grand Blanc, Michigan for VEMCO (the "Contract"). A copy of the Contract is attached to VEMCO's Complaint as Exhibit A.

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[1] The parties agreed that the Contract would be effective as of July 24, 1987.

2. Paragraph 26 of the Contract provides for arbitration of disputes:

> ". . . in accordance with the Commercial Arbitration Rules of the American Arbitration Association; and any judgment upon the award rendered may be entered in any Court having jurisdiction thereof."

3. FEDERAL, as surety, and FLAKT, as principal, provided a Payment and Performance Bond to VEMCO to assure the faithful performance of FLAKT under the Contract. (Exhibit A, Payment and Performance Bond, face page).

4. On August 1, 1988, VEMCO filed a demand for arbitration against FLAKT and FEDERAL. (Exhibit B, Demand for arbitration).

5. On September 8, 1988, VEMCO filed the Complaint in this matter, complaining, inter alia, that FLAKT had failed to name its arbitrator within 5 days as required by the Contract, paragraph 26, page 54.

6. On September 9, 1988, this Court entered a Temporary Restraining Order requiring FLAKT, inter alia, to name its

arbitrator and to proceed expeditiously with the arbitration. FLAKT named its arbitrator as ordered.

7. On or about September 22, 1988, FEDERAL appeared in this litigation by joining FLAKT in portions of the Counterclaim.

8. On or about October 18, 1988, FEDERAL and FLAKT filed their Motion for Order Determining and Staying Arbitrable Claims.

9. By Memorandum Opinion and Order dated March 22, 1989, this Court rejected the position of FLAKT and FEDERAL and held, at page 7 of the opinion, that the arbitration provisions covered all disputes which arise from the Contract.

10. FLAKT and FEDERAL appeared and defended the Arbitration through some 114 days of arbitration testimony and argument before arbitrators Robert G. Russell, Joel H. Serlin, and Paul Reehil, under the auspices of the American Arbitration Association.

11. FEDERAL specifically agreed to be bound by the arbitration proceedings as to those matters which were to be arbitrated. (Exhibit C, letter dated

March 31, 1989).

12. By consent of the parties upon the record, no time limit was placed on issuance of the Arbitration Award. (Exhibit D, correspondence regarding issuance of Award.)

13. On July 8, 1993, the American Arbitration Association entered and transmitted its June 15, 1993 Arbitration Award of $3,111,422.44, plus certain interest, in favor of VEMCO. (Exhibit E, Arbitration Award).[2]

14. To date, neither FLAKT nor FEDERAL have paid any portion of the amounts awarded in the Arbitration Award.

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[2]The Arbitration Award caption names only FLAKT, and the text of the award does not specify whether the award was against FLAKT and FEDERAL, jointly and severally, or only against one of them.

Since (a) FLAKT and FEDERAL are jointly and severally liable on the bond, (b) Vemco's demand for arbitration named both as respondents, and (c) FEDERAL agreed to be bound by the arbitration proceedings on all arbitrated issues, VEMCO asserts that the Award, unambiguously imposed joint and several liability on FLAKT and FEDERAL. Accordingly, VEMCO seeks confirmation of the award against FLAKT and FEDERAL, jointly and severally.

15. Although there are multiple claims for relief presented in this litigation which was commenced in September, 1988, there is no just reason for delay in entering a final judgment upon the arbitration award. Almost five years have elapsed since this litigation was commenced. VEMCO's property remains encumbered by both a claim of construction lien and a lis pendens, which adversely affect VEMCO's full legal rights in the property. Justice requires that a final judgment be entered upon the Arbitration Award.

16. In compliance with L.R. 7.1, counsel for Vemco sought concurrence in the relief sought in this Motion from Denis C. Monahan, Counsel for FLAKT and FEDERAL, on Wednesday, July 21, 1993, at 4:00 p.m., but concurrence was denied.

17. Vemco requests that the issue of costs, attorneys' fees and arbitration fees be deferred for future decision.

WHEREFORE, for the reasons as set forth above and in VEMCO's Brief in Support of this Motion, VEMCO requests the following relief:

A. Entry of an order confirming the June 15, 1993 Arbitration

Award in this matter, as against FLAKT and FEDERAL, jointly and severally.

B. Discharge of the construction lien and lis pendens against VEMCO'S property in Grand Blanc, Michigan.

C. Issuance of a Fed. R. Civ. P. 54(b) certification that there is no just cause for delay, and directing entry of a final judgment on the Arbitration Award against FLAKT and FEDERAL, jointly and severally.

D. Entry of final judgment against FLAKT and FEDERAL, jointly and severally, upon an order confirming Arbitration Award.

E. Issuance of an order that the issue of costs, attorneys' fees and arbitration fees be deferred for future decision.

KEYWELL AND ROSENFELD

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APPENDIX K

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

RESPONSE TO MOTION FOR CONFIRMATION OF THE ARBITRATION AWARD AND FOR FINAL JUDGMENT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
(Flint Administrative Unit)

VEMCO, INC.,
a Michigan corporation,

Plaintiff and
Counter-Defendant,

v.

Civil Action
No. 88CV40331FL
JUDGE STEWART A.
NEWBLATT (P 18257)

FLAKT, INC.,
a Delaware corporation,

Defendant and
Counter-Plaintiff;

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RESPONSE TO VEMCO'S MOTION FOR CONFIRMATION OF ARBITRATION AWARD AND FOR FINAL JUDGMENT ON ARBITRATION AWARD

Flakt, Inc. ("Flakt") and Federal Insurance Company ("Federal"), Defendants and Counter-Plaintiffs, respond to Vemco's Motion For Confirmation Of Arbitration Award And For Final Judgment On Arbitration Award as follows:

1. Flakt and Federal admit the averment except that while Vemco's Complaint stated that a copy of the Cost Plus Agreement was attached, no copy was in fact attached. (There were three (3) written contracts and one (1) oral contract between Flakt and Vemco. The three (3) written contracts included what is described herein as the Cost Plus Agreement, the Guaranteed Maximum Cost or GMC Agreement and the Repurchase Agreement. None of these were attached to Flakt's copy of the Complaint, but it is presumed from the description that Vemco is referencing the Cost Plus Agreement).

2. Flakt and Federal deny the averment for the reason that the partial excerpt from the Cost Plus Agreement mischaracterizes the limited arbitration clauses in the Cost Plus Agreement. (There are no arbitration clauses in any of the other agreements).

3. Flakt and Federal admit the averment.

4. Flakt and Federal admit the averment.

5. Flakt and Federal admit the averment.

6. Flakt and Federal admit the averments.

7. Flakt and Federal admit the averment.

8. Flakt and Federal admit the averment.

9. Flakt and Federal admit the averment.

10. Flakt and Federal admit the averment.

11. Flakt and Federal admit the averment.

12. Flakt and Federal admit the averment.

13. Flakt and Federal admit the averment. In response to what may be averments set forth in Vemco's footnote 2, Flakt and Federal admit that the Arbitration Award caption names only Flakt. The text makes reference only to Flakt and does not "unambiguously impose[] joint and several liability on Flakt and Federal" as claimed by Vemco. Quite to the contrary, the Arbitration Award makes no reference whatsoever to Federal or to joint and several liabil-

ity. The Arbitration Award unambiguously imposes no liability on Federal.

14. Flakt and Federal admit the averment.

15. Flakt and Federal admit the factual averments only and deny the legal conclusion. Vemco's mere recitations of the phrase "no just reason for delay" does not satisfy the requirements of F.R.Civ.P. 54(b). Vemco alleges no good reason to break this case into separate parts and initial a piecemeal appellate process. Furthermore, if the Court were to grant Vemco's request to defer the "issue of costs, attorneys' fees and the arbitration fees, it would be particularly inappropriate to confirm part of the Arbitration Award and to declare the order confirming the Arbitration Award a "final judgment" and then for the court to subsequently consider Vemco's request to vacate part of the Arbitration Award and have the Court award Vemco costs and charges of arbitration not included in the Arbitration Award by the Arbitrators.

16. Flakt and Federal admit the averment.

17. Flakt and Federal deny that there is any issue of costs, attorneys'

fees or arbitration fees to be deferred for future decision. The Cost Plus Agreement General Conditions, Paragraph 26, p. 55 (See Flakt's Counterclaim, Exhibit 1), provided that: "the arbitrators shall fix their own compensation, unless otherwise provided by agreement, and shall assess the cost and charges of arbitration upon the parties". The Arbitrators chose not to award Vemco any costs or charges of arbitration. Therefore, to the extent that Vemco's request relates to costs, attorneys, fees or arbitration fees related to the arbitration, Vemco's request is contradictory with Vemco's request to confirm the Arbitration Award and is actually a request to vacate part of the Arbitration Award and substitute the court's decision for the Arbitrators, decision as to costs and charges of arbitration.

WHEREFORE, Flakt and Federal request that:

A. The Court deny Vemco's Motion For Confirmation Of Arbitration Award And For Final Judgment On Arbitration Award including Vemco's request to discharge Flakt's claim of construction lien and lis pendens, to revise the award to make Federal jointly and severally liable, to certify the order as

a final judgment or to defer the issue of costs, attorneys' fees or arbitration fees;

B. The Court refuse to confirm the Arbitration Award because it improperly includes an award of interest as damages from a date preceding the date said damages were alleged to have occurred and interest at a rate in excess of the rate requested by Vemco;

C. The Court vacate the Arbitration Award for the reasons set forth in Flakt's Motion To Vacate Arbitration Award filed this date; and

D. Flakt and Federal be granted any other relief to which they are entitled.

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Dated: August 27, 1993

(2)

Supreme Court, U.S.
FILED
FEB 19 1997
CLERK

No. 96-1146

In The
Supreme Court of the United States

October Term 1996

VEMCO, INC.,

a Michigan corporation,

Petitioner,

vs.

FEDERAL INSURANCE COMPANY,

a New Jersey corporation,

Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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February 19, 1997

16 pp

QUESTION PRESENTED FOR REVIEW IF PETITION FOR WRIT OF CERTIORARI WERE GRANTED

Were this Court to grant petitioner's Petition For Writ Of Certiorari only one question would be presented for review: Did counsel for the principal and its surety in this case, in correspondence with petitioner's counsel, agree that the surety waived previously-made objections to arbitration, waived its right to appeal, and would be bound to an arbitration award even if vacated on appeal and therefore not binding on the principal?

RULE 29.6 STATEMENT

Respondent Federal Insurance Company's parent company is Chubb & Son, Inc; Federal has no non-wholly owned subsidiaries.

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STATEMENT OF THE CASE

A. The Underlying Action And Vemco's Contention Against The Surety Federal

In this action, the United States Court of Appeals for the Sixth Circuit ("Sixth Circuit"), in an unreported decision, vacated an arbitration award that had been entered in favor of Vemco, Inc. ("Vemco") and against Flakt, Inc. ("Flakt") and Flakt's surety on a performance bond, Federal Insurance Company ("Federal"). The underlying disputes arose under a contract pursuant to which Flakt was to design, fabricate and install in Vemco's plant a paint finishing system to paint automotive parts. [R.8 Exs. 1, 50 to Counterclaim.][1/]

The district court, at Vemco's urging and over Flakt and Federal's objection, had ruled that all contract disputes were subject to arbitration under the terms of the Vemco-Flakt contract. [App. D-29.] The Sixth Circuit disagreed, ruling that [App. A-11]:

> [A]lthough the parties' agreement contains several arbitration clauses, none is so broad as to support the construction urged by plaintiff, i.e., that the parties agreed to submit to arbitration all of their disputes.

Vemco is not challenging this decision, and the case is back before the district court to proceed in accordance with the Sixth Circuit's decision.

1/ As used herein, "R." refers to the record on appeal in the Sixth Circuit. "App." refers to the Appendix attached to Vemco's Petition For Writ Of Certiorari ("Petition" or "Pet.").

The sole issue that Vemco is raising in its Petition pertains only to the surety Federal. Vemco contends that, in a series of letters exchanged with counsel for Vemco, the attorney who represented both Flakt and Federal waived the objections Federal had previously made to the arbitration, waived Federal's right to appeal, and agreed that Federal would be bound by the arbitration award even if vacated on appeal as to Federal's principal Flakt.

This issue was hardly touched upon below. Vemco devoted three pages of its 46-page brief in the Sixth Circuit to the issue; the Sixth Circuit devoted to it only one paragraph of its unreported opinion.

B. The Facts As To The Surety Federal

On August 1, 1988, Vemco made an arbitration demand on both Flakt and Federal. [R.1 Ex. C to Verified Complaint [Etc.].] On September 8, 1988, Vemco filed this action against Flakt [R.1], and on September 9 Vemco obtained a temporary restraining order ("TRO") ordering Flakt, *inter alia*, to proceed with the arbitration proceeding [R.5; App. C-19].

On September 27, 1988, Flakt and Federal filed a counterclaim against Vemco which, *inter alia*, sought a stay of arbitration and an order determining the scope of arbitration. [R.8 Counterclaim at 38-42.] Flakt and Federal alleged that, "[t]here are a number of disputes in

this case which are not within the scope of the arbitration." [*Id.* ¶193 at 40.][2/]

On October 18, 1988, Flakt and Federal filed a Motion For Order Determining And Staying Arbitrable Claims in which they argued that [R.15 Motion at 5-6, ¶14]:

> The Agreement contains very narrow and limited arbitration provisions, which apply to few, if any, of the disputes or claims between Flakt and Vemco . . . .

The district court ruled on Flakt and Federal's motion by order dated March 22 and entered March 23, 1989. [App. D.] It rejected Flakt and Federal's position that the contract's arbitration provisions were narrow and limited, agreed with Vemco that all contract claims were subject to arbitration, and referred all contract claims to arbitration. [App. D-29, D-31.][3/]

[2/] Vemco states that by filing the counterclaim with Flakt "Federal appeared in the litigation picture," Pet. 8; Vemco fails to advise the Court that it had made its arbitration demand on both Flakt and Federal.

[3/] It is not true, as Vemco states, that the effect of the district court's March 23, 1989 order was "leaving intact its September 9, 1988 order mandating Flakt to arbitrate," Pet. 8 (Vemco's emphasis), or that the district court "purportedly ordered Federal to participate in Arbitration," Pet. 19.

(continued...)

Notwithstanding the district court's ruling, Vemco's counsel was concerned about Federal's status in the arbitration because Federal's construction bond had no arbitration clause. [Pet. 9.] In an exchange of correspondence commencing one week after the district court's ruling, Vemco's counsel urged counsel for Flakt and Federal to agree that Federal submit to the arbitration. [App. G.] In response, counsel for Flakt and Federal pointed out that Federal "does not even need to be named

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[3/](...continued)

The March 23, 1989 order defined for the first time the *scope* of the arbitration, something that was not done in the September 9, 1988 TRO. And the district court *actually*, not "purportedly," directed its March 23, 1989 order to all three parties, including Federal. The district court first stated that, "Flakt and Federal Insurance Co. *will be jointly referred to as 'Flakt.'*" [App. D-22, n.1. (emphasis added)] The district court then explained that [App. D-29 (footnote omitted)]:

> Flakt contends that the only arbitrable claims are those that involve a determination of the costs of extras not approved by Vemco and those that arise from the drawings and specificaitons. Vemco, on the other hand, contends that the arbitration provisions cover all the disputes which arise from the contract. . . . The Court agrees with Vemco and finds that the arbitration provisions cover all disputes which arise from the contract.

The district court referred those claims to arbitration. [App. D-31.]

in the arbitration proceeding." [App. G-56.] Federal, as surety, would be liable on the bond if Flakt were found liable, whether or not Federal was a party. Also, Flakt, as principal, was obligated to indemnify Federal, the surety. [*See* App. G-55 - G-56.] Since Federal's legal position was the same whether or not a party to the arbitration, counsel for Flakt and Federal ultimately agreed that Federal would "participate in and be bound by the . . . arbitration proceedings." [App. G-63.]

Nothing in the correspondence exchanged between counsel states that Federal was waiving the position it had just taken in the district court that the arbitration provisions "apply to few, if any, of the disputes or claims between Flakt and Vemco." [R.15 Motion at 5-6, ¶14.] Nothing in that correspondence states that Federal was waiving its right to appeal from the district court's order rejecting that position. Nor does the correspondence state that Federal was agreeing to be bound by an arbitration award that was reversed on appeal as to its principal, Flakt.

Vemco summed up in its motion to confirm the arbitration award what Federal had agreed to when Vemco told the district court that [App. J-146, ¶11 (emphasis added)]:

> Federal specifically agreed to be bound by the arbitration proceedings *as to those matters which were to be arbitrated.*

Federal did *not* agree to be bound as to matters which the Sixth Circuit ruled were *not* to be arbitrated. Nor did Federal agree to be bound by an arbitration award which, because vacated on appeal, would not bind its principal, Flakt. As Vemco told the arbitrators three years after the

exchange of letters between counsel, "[t]he surety's liability is coextensive with the principal's liability." [R.255 Ex. A to Flakt, Inc's Motion To Vacate Arbitration Award at 19.][4/]

Notwithstanding what it had told the district court and the arbitrators, Vemco argued in the Sixth Circuit that the surety Federal had waived its right to appeal and was liable for the arbitration award even if the award were reversed

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4/ Vemco's statement that "Federal had not filed a motion challenging the arbitration award," Pet. 12, is wholly misleading. The initial arbitration award, made on June 15, 1993, named only Flakt as a respondent. [R.252 Ex. E to Vemco's Motion For Confirmation [Etc.].] Therefore, only Flakt moved to vacate the award. [R.255.] Flakt moved on the same ground that it had unsuccessfully asserted prior to the district court's referring all contract claims to arbitration, that the "Arbitration Clauses . . . do not authorize arbitration of many of the disputes submitted to and decided by the Arbitrators." [R.255 Flakt, Inc.'s Brief [Etc.] at 8.]

While Flakt moved to vacate the arbitration award, Vemco moved for judgment confirming the arbitration award against both Flakt and Federal [App. J], and both Flakt and Federal opposed that motion [App. K]. In their opposition to that motion, both Flakt and Federal adopted the position taken by Flakt in Flakt's motion to vacate. [R.254 Brief In support Of Response [Etc.] at v-vi and 3.]

On September 1, 1993, the arbitrators amended their award to add Federal as a respondent. [R.260 Ex. B to Vemco's Reply [Etc.] at 2.]

as to its principal Flakt. The Sixth Circuit disposed of that argument in one paragraph, stating that [App. A-14]:

> Finally, and contrary to plaintiff's assertions, defendant and its surety Federal did not waive their right to appeal by arguing their claims before the arbitration panel. Defendant and Federal requested a determination of arbitrable issues in the district court. They then abided by the district court's determination that all but two issues were arbitrable. "This is not a situation where [parties] consented to arbitration and are now seeking a second bite at the apple." *Wiepking [v. Prudential-Bache Sec., Inc.],* 940 F.2d [996,] at 999 [(6th Cir. 1991)].

ARGUMENT

REASONS FOR DENYING THE WRIT

Vemco seeks to hold a surety liable for an arbitration award vacated against its principal. Vemco seeks this result on the basis of a series of letters between lawyers. The question presented is nothing more than how to interpret those letters. The decision below implicates no federal policy and contradicts no ruling of this Court or of any of the courts of appeals. The Petition should be denied.

I. The Petition Misstates The Question Presented

This case does not present the question set out at page (i) of Vemco's Petition. No question is presented in this case regarding the validity, irrevocability or enforceability of a surety's agreement to submit a controversy to arbitration. No such question was posed to or addressed by either the district court or the Sixth Circuit.

The only question in this case is what the attorney for Flakt and Federal agreed to in his correspondence with Vemco's counsel. Did he agree that Federal would be bound, as its principal Flakt would be bound, by a final, enforceable arbitration award? Or did he agree that Federal waived the objections it had raised to arbitration in the district court, waived its right to appeal, and would be bound by an arbitration award even if it were reversed on appeal and not binding on its principal?

It is simply not true that, as Vemco states at Pet. 14, "the Court of Appeals necessarily decided that Federal's . . . Agreement . . . was not enforceable under the Federal Arbitration Act." *See also* Pet. 30. The Sixth Circuit decided no such thing. It is just that the agreement reached in correspondence between counsel was not what Vemco now says it was.

Vemco contends that the attorney for Flakt and Federal waived Federal's objection to the scope of the arbitration, waived Federal's right to appeal and agreed that Federal would be bound by an arbitration award that was erroneous as a matter of law and that therefore did not bind its principal, Flakt. That contention is farfetched, makes

no sense, and clearly was not the understanding of the parties.[5/]

[5/] Contrary to the apparent suggestion at Petition 5, 12 and 16, n.4, the district court did *not* indicate that it agreed with the position Vemco is now taking. Having erroneously concluded that the arbitration award was valid and binding on Flakt, the district court ruled that it was also binding on Federal. The district court did *not* suggest that an erroneous award vacated as to Flakt would still be binding on Federal.

There is no conceivable reason why the attorney for Flakt and Federal would voluntarily agree that the surety Federal would be bound by an arbitration award that did not bind the principal Flakt. By voluntarily expanding the scope of Federal's potential liability beyond that of its principal, the attorney would be running the risk that Federal would lose its right to be indemnified by its principal. On the other hand, if Federal did not lose its right to be indemnified, increasing the scope of Federal's potential liability would also increase the scope of Flakt's potential liability.

Contrary to Petition at 21, Vemco gave Federal no consideration for Federal's allegedly agreeing to be bound by an arbitration award expanding its potential liability beyond its performance bond. Refraining from amending its pleadings to seek relief from Federal is no consideration when Federal was already a party to the action and a party to the district court's order submitting all contract issues to arbitration.

Vemco was right when it told the district court and the arbitrators that Federal had agreed to arbitration "as to those matters which were to be arbitrated" and that "[t]he surety's liability is coextensive with the principal's liability." *See* pages 5-6 above. Vemco is wrong in the contrary position it took in the Sixth Circuit and is taking in the Petition.

More important, Vemco's contention raises nothing more than a question as to how correspondence between counsel in this case should be construed. That is not a question that warrants review on certiorari.

II. There Is No Reason For Review On Certiorari

Because Vemco's Petition raises nothing more than a fact-specific question of how correspondence between counsel should be construed, it does not present a question that is appropriate for review on a writ of certiorari.

The Sixth Circuit's decision in this case does not conflict with another United States court of appeals or a state court of last resort; nor does it call for the exercise of this Court's supervisory power. *See* S. Ct. Rule 10(a). Vemco does not claim to the contrary.

Following the language of Supreme Court Rule 10(c), Vemco states that the supposed error by the Court of Appeals "presents an important question of federal law that has not been, but should be, settled by this Court." [Pet. 7.] But Vemco fails to state what the question is or in what manner it is unsettled. In fact, Vemco's Petition raises no question of federal law of any kind.

In its Petition, Vemco cites seven decisions of this Court and Sections 2 and 10 of the Federal Arbitration Act, 9 U.S.C. §§2 and 10; none of those decisions or sections are relevant to the issue raised in the Petition, and none were cited in the three pages that Vemco devoted to the issue in its Sixth Circuit brief. Vemco also relies on an apparently unpublished paper on general indemnity agreements. *See* Petition 15 and App. I. That paper does not deal with federal law, agreements to arbitrate or purported waivers of objections to arbitration; in no way does it support Vemco's request for review.

There is not even an arguable basis for reviewing the Sixth Circuit's ruling on certiorari.

CONCLUSION

For the reasons stated above, we respectfully request the Court to deny the Petition.

Dated: February 19, 1997

Respectfully submitted,

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Nº.

In The
Supreme Court of The United States
October Term 1996

VEMCO, INC., a Michigan corporation,
Petitioner,

v.

FEDERAL INSURANCE COMPANY,
a New Jersey corporation,
Respondent.

Petition For A Writ Of Certiorari
To The United States Court of
Appeals For The Sixth Circuit

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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14 pp

QUESTION PRESENTED FOR REVIEW

Whether a construction surety's written agreement to submit an existing controversy to arbitration is valid, irrevocable, and enforceable under the Federal Arbitration Act, notwithstanding the surety's prior unsuccessful objection to court-ordered arbitration.

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PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

In support of its Petition for a Writ of Certiorari (the "Petition" or "Pet."), Vemco, Inc. ("Vemco") replies to Federal Insurance Company's Brief in Opposition to the Petition as follows:

A. There Are No Factual Issues to Be Resolved by The Court in this Case

In an attempt to defeat Vemco's Petition, the Respondent, Federal Insurance Company ("Federal"), has tried to color the question presented by Vemco's Petition as one laden with factual issues that must be resolved by the Court. To the contrary, there are no issues of fact to be resolved by the Court in this case.

1. Any Ambiguities as to the Meaning of the Agreement to Arbitrate and to Be Bound by Arbitration and/or Federal's Underlying Intentions Pertaining to the Agreement Are Issues of Law Which Must Be

Resolved in Favor of Arbitration

The uncontroverted record in this case demonstrates that, after the District Court ordered Federal to arbitration and after two months of negotiations and the exchange of numerous letters on the subject, see Pet. at Appdx. G, Federal signed a document in which it agreed to arbitrate and to be bound by arbitration ("Agreement"):

> Please be advised that Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety issues and non-surety issues.

See Pet. at Appdx. G-63.[1]

Federal does not dispute this fact. It merely claims that the Agreement does not

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[1]Contrary to Federal's argument, Vemco does not seek to hold Federal liable based on "a series of letters between lawyers," but only on one letter -- Federal's Agreement -- The other letters were discussed in the Petition only to show the Court that Federal's Agreement was no "slip of the tongue," but the result of negotiations between the parties.

mean what the District Court[2] concluded it means and that the meaning of the document is a question of fact. Federal's argument is simply wrong. The interpretation of the Agreement is an issue of law, not one of fact.

As Vemco's Petition discusses in detail, any ambiguity in the meaning and scope of an agreement to arbitrate must, as a matter of law, be resolved in favor of arbitration. See Pet. at 21-25. Moreover, even ambiguities as to a party's intention in entering into an arbitration agreement must, as a matter of law, be generously construed in favor of arbitrability. See Pet. at 23. Importantly, Federal has not challenged either of these principles of law.

Based on these principles and the record before this Court, as well as the Court of Appeals, the meaning of the Agreement is, as a matter of law, what the District Court held it is: an Agreement which, by its very terms, binds Federal to

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[2]Moreover, contrary to Federal's assertion, the District Court did make a factual determination that Federal had agreed to be bound by arbitration. See Pet. at Appdx. E-34.

the arbitration results.

2. There Are No Ambiguities in the Record Which Could Give Rise to An Issue of Fact[3]

Federal has attempted to inject ambiguity into the record by putting at issue its intent in entering the Agreement. Federal should not be allowed to interject its arguments on intent at this eleventh hour because Federal never made them earlier in the case.[4]

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[3]Federal's Brief goes a great length in attempting to create the illusion that there are numerous issues of fact buried in this Petition. For example, Federal spends one whole page of its eleven-page brief explaining how Vemco's description of the District Court Order mandating arbitration is incorrect because, like Flakt, Federal was also ordered to arbitrate. However, whether or not the District Court ordered Federal to arbitrate is not even an issue in this case because Vemco has conceded that to be the case for purposes of the Petition. See Pet. at 8 n.2. The issue in this case is whether Federal's subsequent Agreement to arbitrate is valid and enforceable.

[4]Federal's arguments on intent were neither made before the District Court nor the Court of Appeals. See Pet. at Appdx. E-36 [District Court Order Confirming Arbitration Award] ("...Federal agreed to be bound by the arbitration. Federal has presented no reason why it should not be so bound.") (citation omitted); Pet. at 17 n.5 (Vemco's discussion of Federal's arguments on appeal, which has not been disputed by Federal).

Even if the Court were to entertain Federal's arguments on intent, those arguments should fail because they do not raise issues of fact or ambiguities in light of the undisputed evidence in the case. Indeed, even without reference to the record, Federal's arguments must be rejected because they defy logic even when viewed in isolation from the record.

The only hard facts on the record relating to the issue of intent are that Vemco and Federal negotiated Federal's Agreement for two months, Vemco told Federal that it would make Federal a defendant in the District Court lawsuit unless Federal agreed to arbitrate and to be bound by the arbitration as to surety and non-surety issues,[5] and Federal ultimately signed an Agreement to that effect.

Having "fought the good fight" on the issue of arbitrability, Federal elected the course best suited to a speedy and final resolution of its liability: Arbitration.

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[5]Contrary to Federal's allegation, Vemco never named Federal as a Defendant in the District Court lawsuit. Federal's role in that lawsuit always was that of a third party plaintiff.

Having lost the arbitration, Federal now argues that all it intended to do throughout the two months of negotiations between the parties and in finally entering the Agreement was to appease Vemco's concern about the lack of an arbitration clause in the Bond. This argument boggles the mind. Federal would have this Court believe that it signed a document with language as sweeping as that which is contained in the Agreement at issue out of sheer benevolence for Vemco. Not only is such a position inconceivable, given that the parties were opponents in a lawsuit, but is also unsupported by one iota of evidence in the record.

Federal further claims that it signed the Agreement because its rights were not affected by it -- Federal's theory being that its position would have been the same whether or not a party to the arbitration and whether or not a party to the Agreement binding it to the arbitration results.[6] This assertion is

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[6]Needless to say, because no rational party would enter into an agreement believed to be detrimental to its own interest gratuitously or just to appease its opponent, Federal must now argue that the Agreement was not detrimental to its own interest in order to bolster the credibility of its prior argument. However, the Agreement was detrimental to Federal's

preposterous. As a surety, Federal had available special surety defenses, such as invalidity or unenforceabiliy of the Bond, which would not have been addressed in an arbitration between Vemco and Flakt. Thus, had Vemco not obtained an Agreement to arbitrate and to be bound by arbitration from Federal, Vemco would have been forced to bring a lawsuit on the Bond in the District Court, where issues specific to the Bond and unrelated to Flakt's principal liability would have had to be resolved. Therefore, there is simply no objective basis in the record to support Federal's position.

Lastly, Federal argues that its Agreement to arbitrate and to be bound by arbitration could not have meant what the Agreement's plain language provides because, if Federal had agreed to that, it would have been increasing its exposure by jeopardizing its right to indemnification from Flakt. That argument should be ignored for two reasons. First, Federal's interpretation of

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interest, as anyone reading the broad verbiage of the Agreement would be remiss not to conclude ("...Federal Insurance Company has agreed to participate in and be bound by the above arbitration proceedings both as to surety issues and non-surety issues.")

its indemnification agreement with Flakt is unsubstantiated by any evidence in the record since the indemnification agreement is not a part of it. Secondly, even if it were true that Federal did not anticipate all of the legal repercussions of its Agreement to arbitrate and to be bound by arbitration at the time it signed the Agreement, Federal has never cited any law which would relieve Federal from its obligations under the Agreement on this basis.[7]

In sum, the record is uncontroverted that Federal signed a negotiated Agreement which sweepingly commits Federal to arbitrate all issues in the case and to be bound by arbitration without any reservation whatsoever. The undisputed evidence in the case renders the record unambiguous with respect to the meaning of this Agreement and/or Federal's intent. Furthermore, even if the record were ambiguous with respect to either of those two issues, all ambiguities must, as

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[7]Federal argues that neither the letters nor the Agreement spell out that Federal was waiving its right to appeal the arbitration or that Federal would be bound by the arbitration award even if the same was vacated as to Flakt. However, there is nothing ambiguous or tricky about the words "bound by the above arbitration." "Bound" means "bound."

a matter of law, be interpreted in favor of arbitration. Accordingly, and contrary to Federal's argument, this Petition is devoid of any questions of fact to be resolved by the Court.

B. The Court of Appeals' Refusal to Enforce Federal's Uncontroverted Arbitration Agreement Does Contravene the Federal Arbitration Act, Federal Policy, and Precedent from this Court

As Vemco's Petition makes clear, the Court of Appeals had, based on the record before it and substantial precedent from this Court interpreting the Federal Arbitration Act, an absolute obligation to interpret Federal's Agreement in favor of arbitration. See Pet. at 21-25, 27-28.

The Court of Appeals avoided the enforcement of this binding Agreement by concluding that Federal had done nothing more than obey the District Court Order mandating Federal to arbitrate. See Pet. at 13-14. This conclusion is not only erroneous as a matter of law, see Pet. at 19-21, but contradicts the clear mandate of the Federal

Arbitration Act that agreements to arbitrate ongoing disputes be valid, irrevocable, and enforceable, as well as the federal policy favoring the enforcement of arbitration agreements which has been repeatedly announced by this Court.

CONCLUSION

Based on the foregoing, Vemco believes that the Petition richly merits the Court's attention and respectfully requests that it be granted.

Respectfully submitted,

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